

**PAYDAY ADVANCE CREDIT IN AMERICA:
AN ANALYSIS OF CUSTOMER DEMAND**

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Credit Research Center

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About the Center:

The Credit Research Center was founded in 1974 by Robert W. Johnson, Professor of Finance at Purdue University's Krannert Graduate School of Management. The center's founding was an outgrowth of Dr. Johnson's services as presidential appointee to the National Commission on Consumer Finance in 1969. During its 3-year existence the Commission coordinated a massive research program to study the operation of consumer credit markets in the United States. Delivered to Congress in 1972, the Commission's multi-volume report established the value of academic research for guiding public policy towards markets for financial services. With a combination of foundation and corporate grants, Dr. Johnson established the Credit Research Center at Purdue to provide an ongoing means of directing academic research expertise toward practical problems in consumer and mortgage credit markets.

Over the past quarter-century the Center has gained a national reputation for its work in evaluating public policy toward credit markets. The Center's operations have been sustained by generous grants from both the public and private sectors. Over one hundred articles and monographs by distinguished scholars document its research product. The Center's senior research staff have frequently testified before Congress and state legislatures on such topics as Truth-in-Lending disclosures, the impact of interest rate ceilings on credit availability, equal credit opportunity regulations, personal bankruptcy, credit insurance, credit scoring, credit card usage, and the impact of privacy regulations. The value of these contributions to rational discourse stems from CRC's academic affiliation, rigorous external review of its research, and the years of research experience of its principal researchers and authors.

In July of 1997 the Center relocated its offices to Georgetown University in Washington, D.C. The Center is a non-profit unit of the McDonough School of Business where it continues its tradition of non-partisan research and education on economic issues relating to consumer credit and markets for retail financial services. For more information about the Center and its publications visit its website at www.msb.edu/prog/crc.

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EXECUTIVE SUMMARY

This monograph investigates consumers' demand for payday advance credit. The data for the investigation are from a nationally representative sample of customers of payday advance companies belonging to the industry trade association, the Community Financial Services Association of America. Member companies operate about half of the approximately 10,000 offices offering payday advance credit. The survey was conducted from December 28, 2000 to January 9, 2001.

The payday advance industry emerged during the 1990s to cater to unfulfilled demand for very small, short-term consumer loans. Payday advance customers are primarily moderate-income consumers who are often in early stages of the family life cycle. They are more likely to use consumer credit and tend to have higher levels of consumer debt relative to income than the population as a whole. According to previous research, such consumers typically have high rates of return on investments in household goods. Because of the high return on household investment, they have strong demand for credit, which at the margin makes them insensitive to interest rates on loans. Thus, payday advance customers' use of such credit, which has very high annual percentage rates, is consistent with the predictions of economic theory and previous empirical research.

Payday advance customers are generally aware of the cost of such credit. Nearly all payday advance customers were aware of the dollar amount of the finance charge on their most recent new advance. But few were able to report accurate annual percentage rates despite recalling receipt of that information in Truth in Lending disclosures. A likely explanation is that payday advance customers used finance charges rather than annual percentage rates in decision-making. Many costs that customers use payday advances to avoid (e.g., fees for returned checks or late payments) are typically expressed as dollar amounts, not annual percentage rates. Since customers did not use annual percentage rates to make their decision, they did not retain the information in memory.

In other circumstances, payday advance customers may use annual percentage rates. Nearly all payday advance customers owe other types of consumer credit. They are concentrated in the middle levels of educational achievement. Other surveys have found these levels to be associated with relatively high awareness of annual percentage rates for consumer instalment credit. Moreover, payday advance customers who had bank cards were generally aware of the annual percentage rate on the bank card used most frequently.

Many customers recognize that payday advance credit is costly. Although many customers consider the cost of payday advances to be the same or less than fees for returned checks or late payments, a very large number thought payday advances were more expensive. And the small percentage of customers who were dissatisfied with their most recent new payday advance cited the high cost as the reason for their dissatisfaction.

Payday advance customers perceived limitations in credit availability and had fewer alternatives than the population as a whole. Nearly three-fourths of payday advance customers have been turned down by a creditor or not given as much credit as applied for in the last five years. Two-thirds of customers considered applying for credit but changed their mind because they thought they would be turned down. Payday advance customers were less likely than the adult population to have a bank or retail credit card. Of the 56.5% of customers having bank cards, over half refrained from using such cards in the last year because they would have exceeded their credit limit.

Most payday advance customers use advances infrequently or moderately. About half of customers had advances outstanding less than a total of three months during the year, and nearly four in five had advances outstanding less than half of the year. Generally, payday advances were used at different times over the year. Over half of customers' longest consecutive sequence of advances were less than a month. These findings suggest many payday advance customers use payday advances regularly for short periods of time. Attitudes expressed by customers disagreeing with the government limiting the number of times a consumer can obtain payday advances during the year are consistent with such use.

A small percentage of customers had payday advance credit outstanding for more than half of the year, however. These customers may have had few alternatives to payday advances. Nevertheless, the favorable attitudes toward payday advances and the high level of satisfaction with the most recent advance suggest that for many of these customers continued use of payday advance credit was a choice, not a burden from which they could not escape. Of the customers expressing dissatisfaction with their most recent advance, only a very small percentage of customers were dissatisfied because of the difficulty of getting out of debt.

In sum, most payday advance customers use such credit as a short-term source of financing. Nearly all are aware of the finance charge for payday advance credit. Payday advance customers use other types of consumer credit and are likely aware of annual percentage rates for such credit. However, they may have difficulty obtaining additional credit from traditional creditors, especially on an unsecured basis. Thus, payday advances give these consumers a little control over their financial situation that they otherwise would not have. This may explain customers' positive attitudes toward payday advance credit and high levels of satisfaction.

INTRODUCTION

Payday advances are very small, short-term consumer loans. In a payday advance transaction, the customer writes a check for the amount of the loan and finance charge. The creditor agrees to hold the check until the next payday, typically about two weeks, when the customer redeems the check with cash or the creditor deposits the check. Other names for this product are payday loans, cash advances, and deferred presentment services.

Consumer demand for very small, short-term consumer loans is not new. In the latter part of the nineteenth century, small loan companies lent small amounts using chattel mortgages or wage assignments.¹ These small loan companies typically charged annual interest rates ranging from 20-300%, well in excess of the legal interest rate of 6% per annum. Payments were scheduled for every payday. For a typical loan of \$25, payments would be scheduled for 13 weeks. The customers of these companies were primarily government employees, low-level white collar workers, skilled-tradesmen and foremen. These companies served the credit needs of moderate-income workers, who struggled to keep up with their middle-class ambitions.²

The small loan business was illegal, of course. But the usury laws were sporadically enforced, and the business prospered because it served a real need. Eventually, the small loan industry became a target of Progressive reformers, who prosecuted the illegal small loan companies. However, the reformers realized that a need existed and recognized that it was impossible to make a profit on small loans with a 6% interest rate. Therefore, the reformers proposed higher rate ceilings for small loans in exchange for licensing and regulating of creditors extending such credit. Many small loan companies came to accept such proposals, and in 1917 a committee of reformers and small loan companies agreed on model legislation, the Uniform Small Loan Law. The subsequent passage of small loan legislation in many states enabled creditors to make small loans profitably and allowed emergence of the modern finance company industry.

The cost structure of the consumer finance industry is such that operating costs increase less than proportionately with loan size (Benston [1972]; Durkin and Elliehausen [1998]). In other words, companies producing larger loans have lower costs per dollar of credit than companies producing smaller loans. Thus, for a given interest rate, larger loans are more profitable than smaller loans. Perhaps because of increased competition unleashed by deregulation of financial service markets in the 1980s, many finance companies, which historically served the very small loan market, shifted their business to more profitable, large consumer loans. Banks offer revolving credit (bank cards and check credit) to satisfy small and short-term credit needs, but many consumers still have limited access to such credit despite the development of a subprime market for bank cards.

¹ For discussion of the development of consumer credit markets in the nineteenth and early twentieth centuries, see Calder [1999] or Michelman [1966].

² Pawnbrokers were another source of small, short-term loans. In contrast to the small loan companies, pawnbrokers catered to a lower income, working-class clientele (Calder [1999]). The difference in customer profiles suggests that pawnbrokers and small loan companies may have served different market segments.

The payday advance industry emerged during the 1990s to serve a void created by the withdrawal of traditional lenders from the very small loan market. Payday advance credit is different from the small loans offered by finance companies. Payday advances are single payment loans rather than instalment loans, and the underwriting process for payday advances does not involve a credit investigation. Therefore, the costs and risks of the two types of credit are not the same. However, it is likely the factors influencing the demand for these products are similar. This monograph investigates the demand for payday advance credit using new data from a representative survey of customers of payday advance companies belonging to the industry's national trade association, the Community Financial Services Association of America. The strong demand for very small, short-term consumer loans is evident from the growth in the payday advance industry. The number of payday advance offices grew from virtually zero offices in 1990 to over 10,000 offices in 1999 (Stephens Inc. [1999]).

CHAPTER 1

THE PAYDAY ADVANCE TRANSACTION

A payday advance is a small, short-term, single-payment consumer loan.³ In a payday advance transaction, the customer writes a personal check for the sum of the loan amount (amount financed) and finance charge. The payday advance company agrees in writing to defer presentment of the check until the customer's next payday, which is often 10 to 30 days later. At the next payday, the customer may redeem the check by paying the loan amount and the finance charge, or the payday advance company may cash the check. In some states, the customer may extend the payday advance by paying only the finance charge and writing a new check.

Payday advance companies may provide only payday advances, or they may provide payday advances and other services such as check cashing. For this study, payday advance company refers to any company that provides payday advances, regardless of whether the company provides only payday advances or other services as well.

Loan Size and Finance Charges

Payday advances typically range from \$100 to \$500, although some states permit payday advances up to \$1,000. Finance charges are typically between \$15 and \$20 per \$100 of the loan amount. The calculation of the cost of a payday advance is straightforward. Consider, for example, a customer borrowing \$200 for 14 days, where the finance charge is assessed at a rate of \$15 per \$100 borrowed. The finance charge is $\$200 \times (\$15 \div \$100) = \30 . The annual percentage rate for this transaction is 390.00%, which is the periodic rate 15.00% multiplied by 26, the number of 14-day periods in a year.

The Underwriting Process

Many of the costs of consumer lending do not vary by size of loan (see discussion of costs in the next section), making small loans relatively more costly per dollar than large consumer loans. For this reason, payday advance companies have sought to make the underwriting process as streamlined as possible. The underwriting process consists primarily of verifying the applicant's income and the existence of a bank account. Payday advance companies typically request that applicants provide the last bank statement, the last pay stub, identification (e.g., social security number and driving license), and sometimes proof of residence. Companies generally limit the maximum amount of the advance to a specified percentage of the customer's take-home pay. Unlike traditional lenders, payday advance companies do not obtain a credit bureau report. However, some companies do subscribe to a risk assessment service that provides information on current payday advance use by the applicant.

³ State laws governing payday advances vary as to whether the transaction is considered a loan and whether the fee charged is interest. Regardless of treatment under state law, all payday advances are treated as loans for the purposes of this study.

Taking a postdated check helps reduce the costs of collection. If the consumer fails to redeem the check, the payday advance company has a relatively low-cost method of collection. The company can deposit the check to obtain payment of the loan amount and finance charge. Depositing the check does not ensure payment, of course, since the customer may not have sufficient funds in his account. But not having sufficient funds in the account subjects the customer to overdraft fees, which makes failure to repay the payday advance costly to the customer. Thus, the postdated check provides an incentive to repay the payday advance, thereby reducing the probability of default and the expected value of collection costs.⁴

Costs

This study is primarily concerned with a consumer's payday advance decision, not the cost of payday advance credit. Nevertheless, because of the relatively high annual percentage rate, some discussion of the relationship between costs and annual percentage rates is useful for understanding the payday advance transaction. At this time, data on the cost of extending payday advance credit are very limited. However, all creditors perform the same basic activities, and empirical studies of costs of other types of consumer lending provide evidence on the cost of small, short-term loans.

The costs of consumer lending can be classified into several categories: operating costs, taxes, and return on invested capital. Operating costs are the largest category. They arise from the basic functions that all creditors must perform to extend credit. Operating costs include the salaries and office expenses for loan acquisition, processing, and collection of payments, plus expenses for bad debts.

By far the greatest part of operating costs is expenses for loan acquisition, processing of payments, and collection of past due accounts. Loan acquisition costs include the cost of taking an application, evaluating the application, preparing the loan document, and disbursing the funds. Processing costs include receiving and recording loan payments, monitoring accounts to ensure prompt payment, and contacting customers who are past due to arrange for collection of late payments. Lending involves all of these costs, regardless of the size of the loan. This characteristic implies that a substantial part of the cost of lending is fixed. Because of this fixed cost, the breakeven annual percentage rates for consumer lending are inversely related to the size and term to maturity of the loan. Empirical analyses for the National Commission on Consumer Finance [1972] indicate that the breakeven annual percentage rate on a larger loan is less than the breakeven annual percentage rate on a smaller loan. An intuitive explanation for this finding is that the fixed cost is spread over a greater loan size. Likewise, analyses indicate the breakeven annual percentage rate for a longer term to maturity is less than that for a shorter term to maturity. An intuitive explanation for this second finding is that the fixed cost of acquisition is spread over time with a greater number of payments.

These empirical results are based on data from different types of creditors many years ago. However, the activities that creditors must perform are largely the same now as they were

⁴ Theoretical analyses by Jaffee and Russell [1976], Barro [1976] and Benjamin [1978] demonstrate that making default costly for the borrower reduces the probability of default.

then, and all types of creditors must perform them. Although information processing systems automate many of these activities, the labor inputs are still substantial. Application information must be entered into the computer. The computer may prepare the loan document, but employees must explain the document to the customer and disburse the funds. Employees must receive payments and record them into the accounting system. They must extract information identifying past due accounts, contact customers, and arrange for collection of late payments. All of these activities entail substantial fixed costs.

For very small loans, one study for the National Commission on Consumer Finance indicates that breakeven rates are quite high. This study examined costs of the “small” small loan industry in Texas (Durkin [1975]). These small loan companies were specially licensed to make instalment loans of \$100 or less (about \$450 or less in 2001 dollars). The minimum annual percentage rate to recover operating costs for an average loan was about 80%. This rate did not include taxes or return on invested capital. Allowing for taxes and return on invested capital produced a breakeven annual percentage rate of over 100%.

The findings of the various studies for the National Commission on Consumer Finance cannot be used to infer breakeven annual percentage rates for payday advances. Payday advance credit is extended for much shorter terms to maturity and may entail different credit risk than the various types of instalment credit in these studies. Nevertheless, these studies suggest payday advance credit will have high costs relative to loan size because of the small loan sizes and very short terms to maturity.

Regulatory Environment

Payday advance credit is regulated by state and federal laws. In addition, many payday advance companies voluntarily submit to self-regulation, adhering to a set of industry standards promulgated by an industry trade association, the Community Financial Services Association of America.

State Laws

Recent state legislation has made the rapid growth in the payday advance industry possible. At the present time, 33 states and the District of Columbia allow payday advance companies to operate within their borders.⁵ Of the states allowing payday advance companies, 24 have legislation or regulations explicitly authorizing payday advances. Typically, the state payday advance laws exempt payday advances from usury or interest rate ceilings in exchange for establishing maximum fees and rollover limits. The state payday advance laws also require licensing and periodic examinations to ensure that the licensees are abiding by all applicable federal and state laws.

The other 17 states effectively prohibit payday lending through strict interest rate ceilings, which make very small loan sizes unprofitable. For example, Alabama, Alaska, Rhode

⁵ For discussion of state laws and regulations, see Chen, Goodwin, Jaworski and Tolle [2000] or Community Financial Services Association [2000].

Island and Virginia all place a 36% annual interest rate ceiling on small loans. A creditor in these states may charge a maximum of \$2.77 on a \$200 cash advance for two weeks. This amount is considerably lower than the \$30-\$45 that payday advance companies charge for this same product in states that allow payday advances. Since payday advance companies do not operate in states with restrictive interest rate ceilings, it is likely that the 36% annual percentage rate is lower than the payday advance industry's breakeven annual percentage rate for payday advance credit.

State laws also regulate nonprice terms of payday advance transactions in several ways. Some laws limit the number of times an advance may be rolled over or refinanced. Eighteen states (e.g., Colorado, Florida and Kansas) do not permit a payday advance customer to retire an existing advance with the proceeds of a new advance.⁶ Five states (e.g., Idaho and Illinois) permit a current advance to be rolled over no more than three times.

Many payday advance laws limit the size of payday advances. Size limits frequently range between \$300-\$500 per advance. Some states directly limit the size of the advance. Others limit the size of the check, which includes the amount of the advance plus the finance charge. Montana has a variation on size limits that restricts advances to the lesser of \$300 or 25% of the customer's net monthly income. Nevada limits the amount of the advance to one-third of the customer's net monthly income. Many states also limit the aggregate amount of advances to a customer at a company, which is generally the same as the size of the maximum advance. The intent of these restrictions on nonprice terms is to force consumers to use payday advances for short-term needs and to keep the consumers from falling too far into debt.

State laws generally prohibit payday advance companies from threatening defaulting clients with criminal prosecution or civil damage penalties to intimidate or force repayment. Nevada specifically prohibits lenders from harassing defaulting debtors by posting an NSF check in a public area or publishing a list of consumers who have given bad checks. Some state provisions may allow criminal prosecution in cases of fraud, however. Hawaii, for example, allows the criminal process to be used in cases where the consumer either stops payment on the check or closes the bank checking account before the advance has been repaid.

The state laws explicitly authorizing payday advance lending provide for oversight of the industry. The laws impose certain statutory requirements on licensees (e.g., that licensees are bonded and satisfy minimal net worth criteria). The laws usually also require licensees to provide periodic written reports and submit to on-site examinations by regulators. Such requirements help protect consumers from unscrupulous or financially weak lenders. They also help enforce compliance with state and federal laws. Regulation of this type has been effective in driving out companies that are unwilling to satisfy regulatory standards. When Tennessee passed its Deferred Presentment Services Act in October 1997, for example, many existing

⁶ However, a consumer can obtain a new advance from a different company to repay an existing advance. Such action is possible because there is no database listing customers of all payday advance companies. Even if a database existed, it would be difficult to prevent a customer from taking out an advance at one company and immediately repaying an advance at another company.

payday advance companies ceased doing business in Tennessee rather than comply with the new restrictions (Tennessee Department of Financial Institutions [1998]).

To enforce their regulations, most states have criminal or supervisory penalties that can be used against payday advance companies. Some states authorize private enforcement. Seven states allow consumers to file a private cause of action to obtain relief against a payday advance company (Community Financial Services Association [2000]).

Federal Laws

Payday advances are consumer loans and, therefore, are subject to the federal Truth in Lending Act (15 U.S.C. §1601 *et seq.*), which is implemented by the Federal Reserve Board's Regulation Z. Truth in Lending requires a detailed set of disclosures of the price and other terms of consumer credit transactions. The key price disclosures are the annual percentage rate and the finance charge. The annual percentage rate is the periodic interest rate applied to outstanding balances multiplied by the number of periods in a year. The finance charge is the total dollar amount of all interest payments. Other disclosures for payday advance transactions include the amount of the loan (amount financed), the total of payments (for payday advances, the check amount), and the schedule of payments. The Federal Trade Commission has jurisdiction for Truth in Lending for payday advance companies.

The Fair Debt Collection Practices Act (15 U.S.C. §1692 *et seq.*) establishes debt-collection standards for third-party collectors. The act prohibits harassment, false statements, and certain practices in collecting debts. Third-party collectors are collection professionals and firms who assist creditors in collecting past-due accounts. The small advance size makes use of third-party collectors uneconomical. Therefore, very few payday advance companies, if any, use third-party collectors. Payday advance companies normally collect their own past due accounts. However, the industry trade association, the Community Financial Services Association of America, includes limitations of the Fair Debt Collection Practices Act as a guideline for member companies' own collection efforts.

The National Bank Act may have important consequences for the structure of the payday advance industry. The courts have consistently held that the National Bank Act (12 U.S.C. §§ 85-86) allows federally insured banks to charge the higher of (1) the interest rate allowed in the state in which the bank is domiciled or (2) 1% above the discount rate on 90-day commercial paper in the Federal Reserve district in which the bank is located.⁷ In effect, the act preempts state interest rate ceilings of the borrower's home state. Nationally chartered banks are able to export the interest rate they charge in their home state to customers in other states.⁸

⁷ *Marquette v. First of Omaha Serv. Corp.*, 439 U.S. 299 [1978]; *Smiley v. Citibank (South Dakota), N.A.*, 135 L. Ed. 2d 25, 116 S. Ct. 1730 [1996].

⁸ Similarly, the Depository Institutions and Deregulation and Monetary Control Act of 1980 (12 U.S.C. § 1831d(a), §1463(g), § 1785(g), and § 1735f-7a) allows state-chartered banks and other financial institutions accepting federally insured deposits to export rates across state lines.

This aspect of the National Bank Act has induced many financial institutions to establish credit card banks in South Dakota and Delaware, which have no interest rate ceilings for revolving credit. The ability to export interest rates is not limited to revolving credit, for which business is conducted through the mail. Recent court cases suggest a company may enter into an agreement with a national bank in a high-rate ceiling state to provide payday advances through the company's stores located in other states.⁹ The key requirement for such agreements is that the bank grant the advance, but the offices are owned by the company, not by the bank. Several companies currently have such agreements with national banks. Extension of payday advances by national banks limits the ability of states to regulate such credit using interest rate ceilings. It should be noted, however, that the nonprice restrictions imposed by states (discussed in the previous subsection) would still apply, regardless of whether the advance was granted by a bank or a payday advance company.

Self-Regulation

In 1999, several payday advance companies founded an industry trade association, the Community Financial Services Association of America. Currently, the association has over 60 member companies. These companies operate approximately 5,000 offices nationwide. This represents about half of the estimated 10,000 offices making similar short-term loans (Stephens Inc. [1999]).

The primary function of the Community Financial Services Association is to guide industry standards and to promote a favorable regulatory environment for payday advance lending. The crucial element of a favorable regulatory environment is that state price regulation (i.e., interest rate ceilings) does not make payday advance lending unprofitable. In return for nonprohibitive price regulation, the association supports a set of industry standards for payday advance lending, which it designates as "Best Practices." The "Best Practices" consist of the following standards:

- Disclosure of finance charge, annual percentage rate, and all terms of the payday advance transaction;
- Full compliance with applicable state and federal laws;
- A commitment to clear and truthful advertising;
- Consumer education promoting short-term use of payday advance services and informing customers of the availability of credit counseling services;
- Limitation of the number of rollovers to the lower of four or the state maximum, and prohibition where rollovers are not specifically allowed;
- Provision of the consumers right to rescind the transaction at no cost;
- Adherence to limitations on collection practices contained in the Fair Debt Collection Practices Act;
- Renunciation of the threat or use of criminal prosecution to collect on a returned check;
- Participation in self-policing of industry;

⁹ *Cade v. H&R Block, Inc.*, 43 F 3d 869 (4th Cir., 1994); *Christiansen v. Beneficial Nat'l Bank*, 972 F. Supp. 146 (S.D. Ga., 1997); *Basile v. H&R Block, Inc.*, 897 F. Supp. 194 (E.D. Pa., 1995). These cases concern loans made through tax preparation offices.

- Support for state legislation that incorporates the association's standards; and
- When payday advances are extended through an agreement with a national bank, assurance that the national bank adheres to the association's standards.

The complete text of the Community Financial Services Association's "Best Practices" is reproduced in appendix A.

The "Best Practices" include numerous consumer protections. Some of the protections are also contained in state or federal laws. Many states do not have all of the protections of the "Best Practices," however, and the protections in the Fair Debt Collection Practices Act do not apply to payday advance companies collecting their own accounts. Thus, the association's standards constrain member firms' behavior.¹⁰ The association promotes incorporating its standards into state laws. Colorado, for example, passed an improved payday advance law during the 2000 legislative session and was the first state to incorporate the "Best Practice" of providing the consumer a right to rescind the transaction at no cost by the close of the following business day. When incorporated in state law, the standards with their consumer protections and associated compliance costs are imposed on nonmember companies as well as member companies.

Consumer Protection Issues

The relatively high finance charge and annual percentage rate for the payday advance credit has attracted the attention of consumerists, politicians, and regulators and has led to several concerns. The first concern is that the price of payday advance credit is too high. A second concern is that consumers may not be fully aware of the price of payday advance credit. Awareness of the price is important because this information is necessary to make an economically rational decision. As discussed earlier in this chapter, Truth in Lending requires disclosure of the finance charge and annual percentage rate. Disclosure alone does not ensure consumers are aware of the information, however. A third concern is that the high price of payday advance credit imposes a financial burden on customers making it difficult for them to pay-off the debt. As a result, they continually renew payday advances, making such credit a long-term debt. Many state laws and the trade association's "Best Practices" address renewals on a company basis. They do not prevent customers from taking out an advance at one company to repay an advance at another company. Related to the concern over renewals is a belief that payday advance customers would be better-off using less expensive, long-term credit. Finally, the price of payday advances also reflects the high risk of these transactions. These customers have a high probability of repayment problems, which subject them to the collection process. Again, many state laws and the trade association's "Best Practices" have provisions regarding collection practices.

¹⁰ That the "Best Practices" constrain member companies' behavior is suggested by the response of two payday advance companies to the most recent revision to the standards. Two large payday advance companies pulled out of the association rather than assure that the national bank through which it was offering payday advances adhere to all of the restrictions in customers' home states. See Payday Lenders' Group Revises Guidelines, *American Banker* [July 19, 2000].

This monograph is not intended to address the concern that the price of payday advance credit is too high. As mentioned, many states have limited the price of payday advance credit by law. If the limit is lower than the cost of production, the availability of credit will be restricted. Numerous empirical studies have demonstrated this result (see Staten and Johnson [1995]). Restricting availability of payday advance credit in this way would not ensure that consumers get credit from another source or at a lower price, however. Most economists would recommend allowing market competition to determine the price of payday advance credit. Economic theory demonstrates that competitive markets tend to produce the lowest price consistent with the cost of production.

This monograph examines the latter three concerns. The survey of payday advance customers conducted for this study provides evidence on (1) payday advance customers' awareness of finance charges and annual percentage rates; (2) the frequency of renewals, duration of payday advance sequences, and availability of alternative sources of credit; and (3) customers' experiences with past due payday advances. The survey evidence allows an assessment of the extent to which problems arise in the latter three areas.

CHAPTER 2

ANALYZING THE BENEFITS AND COSTS OF A PAYDAY ADVANCE TRANSACTION

The payday advance transaction clearly is a consumer credit transaction. As such, standard economic models are applicable for analysis of payday advance use. The short term to maturity, the use of a postdated check, or the relatively high finance charge do not fundamentally change the method of analysis.

Analytical Model for Consumer Credit Use

Juster and Shay [1964] developed the basic theoretical economic model of consumer credit use. Consumer credit is typically used to finance the purchase of household durable goods, which provide a return in the form of a stream of services over a period of time. The economic value of the stream of services, Juster and Shay argued, can be measured in terms of the cost of purchasing those services in the market. For example, the value of the services of a washing machine could be measured by the cost of obtaining the services in a laundromat, or the services of an automobile could be measured by the cost of using public transport. Even the services of durables such as a television or video recorder can be valued in such a way. The value of services of a television, for example, could be measured by the cost of going to the cinema, a concert, or other entertainment activities that would be undertaken if television were not available. Empirical research suggests that even with conservative assumptions about usage, the rates of return on household durables can be quite high (Poapst and Walters [1964]; Dunkelberg and Stephenson [1975]).

Viewing the purchase of a durable as an investment, the consumer compares the purchase price of the durable with the present value of the services it provides. To determine the appropriate discount rate for computing the present value of the stream of services, Juster and Shay turned to the consumption/investment choice model developed by Fisher [1930] and extended by Hirschleifer [1958]. The model determines the most highly valued inter-temporal pattern of consumption that an individual can achieve given his income stream and investment opportunities and market rates for borrowing and lending. At the optimum point, the rate of return on investment is equated with the appropriate discount rate. This discount rate can be the borrowing rate, the rate of time preference, or the lending rate. The model shows the conditions under which borrowing at high rates may be optimal. These conditions are characterized by relatively high-return investment opportunities, low current income, and preferences for current consumption.

Juster and Shay used this framework to analyze consumer credit markets. Normally, consumer credit is repaid out of future income. Most consumers do not have sufficient liquid assets to repay debts. To reduce default risk, creditors typically require borrowers to build equity in the durable being financed. The equity requirement reduces default risk by making default more costly to the borrower. This requirement may also affect the cost of financing the durable because building equity forces the borrower to forgo current consumption. Borrowers not wishing to forgo current consumption can sometimes obtain additional credit by using unsecured personal credit, but this credit is riskier and therefore more costly than other forms of credit. For

many consumers, additional unsecured personal credit is available only from specialized high-risk creditors at a substantially higher cost.

Juster and Shay referred to borrowers who were constrained by creditors' equity requirements as "rationed" and borrowers who were not constrained as "unrationed." They hypothesized that rationed borrowers would be in early family life-cycle stages, in which rates of return on household investments would be high. These borrowers would also have relatively low or moderate income, which would make sacrifices in current consumption to satisfy equity requirements costly. Rationed borrowers would have relatively low levels of savings, making use of liquid assets to pay for household investment costly to them. According to the theoretical model, rationed borrowers' demand for credit would be unresponsive to increases in annual percentage rates because returns on household investment are high, and the alternatives to credit are more costly. Unrationed borrowers, in contrast, typically would be in later family life-cycle stages or have relatively high incomes. These borrowers would have relatively few high-return household investment opportunities and would have discretionary income to pay for household durables¹¹. Their age and income allow unrationed borrowers to have relatively high levels of savings. Thus, using liquid assets to purchase durables would not be especially costly to unrationed borrowers. The model predicts that unrationed borrowers' demand for credit would be sensitive to annual percentage rates.¹²

Consumer credit markets have changed considerably since Juster and Shay's study. Advances in information and technology have improved creditors' ability to assess risk. Equity requirements have been relaxed, as terms to maturity have lengthened for most closed-end instalment credit. Another consequence of these advances is the growth in availability of unsecured credit through bank credit cards. Today many borrowers use bank cards in much the same way as Juster and Shay described earlier borrowers using unsecured personal loans (see Bizer and DeMarzo [1992]; Brito and Hartley [1995]). A subprime credit card market has developed specifically to serve such borrowers. Still, many consumers do not have bank credit cards, and market innovations have developed to provide credit to rationed borrowers. The emergence of the modern payday advance industry is one such development.

Analysis of the Payday Advance Transaction

A decision to use a payday advance should be evaluated like any other credit transaction. The investment outlay is the expenditure financed by the payday advance. The income from the investment is the expense saved by making the investment. The interest rate for the payday advance is the discount rate for computing the net present value calculation. Use of a payday advance is advantageous if the net present value of the transaction is positive.

¹¹ For example, the return a consumer places on purchasing his only television set would likely be higher than for purchasing a big-screen television or the household's third set.

¹² Empirical evidence from experimental data generally supported the predictions of the theoretical model. See Juster and Shay [1964].

Consider, for example, a consumer who needs \$100 immediately to pay a \$50 utility bill and a \$50 minimum payment on a credit card. Assume he cannot cut \$100 of other expenses between now and the time of his next paycheck. Making late payments might cost \$35 in total, a \$5 late fee to the utility company and a \$30 late fee to the credit card company. Costs not considered in this example include the record of late payments in the consumer's credit history or the inconvenience caused by having one's electric or water shut-off by the utility for nonpayment. With a payday advance fee of \$15 per \$100 advanced, the finance charge is \$15. The periodic rate is 15.00%, which corresponds to a 390.00% annual percentage rate for a two-week advance.

Table 2-1 summarizes the cash flows associated with this example. The consumer receives a \$100 payday advance and immediately pays the bills (the -\$100 investment outlay on day 0. The consumer redeems the payday advance check for \$115 (the amount advanced plus the finance charge) on day 14. The payday advance saves \$35 in late fees and payment of the \$100 bill payments that would have been made on day 14 in the absence of an advance.

2-1 Cash flows for avoiding late payments

(Dollars)

	<u>Day 0</u>	<u>Day 14</u>
Investment	-100.00	135.00
Loan (payday advance)	100.00	- 115.00

The net present value (*NPV*) for taking out a payday advance to avoid late payments is calculated using the investment cash flows as follows:

$$NPV = I + \frac{S}{1 + d} = -\$100 + \frac{\$135}{1.1500} = \$17.39$$

where *I* is the investment outlay (the expenditure financed by the payday advance), *S* is the income from the next pay check including savings in expenses, and *d* is the periodic discount rate. The cost of the payday advance is accounted for by the discount rate. Inclusion of the \$15 interest payment would result in double counting. The \$17.39 net present value indicates that using a cash advance to make timely payments would be less costly than making late payments.¹³

Consider another example involving the repair of an automobile. The consumer needs \$200 to repair an automobile but does not have the cash to pay for the repair. He could delay the repair two weeks until the next payday and use public transportation, or he could obtain a payday advance and have the repair done immediately. To simplify the computations, it is assumed the consumer would use the automobile only for commuting between his home and work for two weeks, beginning on a Wednesday. He borrows the payday advance on a Tuesday evening after work and will pay it back with a fee exactly two weeks later. Further assume the consumer does not use the automobile on the weekends. The net cost of taking public transportation to work is

¹³ Note that \$17.39 is the present value of the \$20.00 net cash flow or savings in table 2.1.

\$4.56 per day, which includes bus and subway fares of \$3.50 each way; a savings of \$3.72 in costs each way for fuel, maintenance, and depreciation of his automobile, and a \$2.50 opportunity cost for an additional 15 minutes commuting time each way.¹⁴ Table 2-2 summarizes the daily costs for the consumer of public transportation versus driving a personal car.

2-2 Daily costs

Daily cost of public transportation

Bus and subway fare ($2 \times \$3.50$)	\$7.00
Less: Savings of fuel, maintenance, and depreciation on automobile ($2 \times 12 \text{ miles} \times \0.31 per mile)	\$7.44
Plus: Opportunity cost for additional commuting time ($2 \times 0.25 \text{ hours} \times \10 per hour)	\$5.00
Equals: Net savings from driving car	\$4.56

As in the first example, assume a payday advance charge of \$15 per \$100 advanced. The finance charge for a \$200 advance is \$30. In this example, the periodic discount rate d is a daily rate of 1.07% ($390.00\% \div 365$). The net present value is the total of the discounted cash flows in table 2-3.¹⁵ The net present value of the transaction is \$14.55, which indicates that using a cash advance to repair the automobile now would be less costly than waiting until the next payday.¹⁶

¹⁴ Public transport fares are based on the cost of commuting from a Washington, DC suburb to the District during rush hour. The \$3.50 fare is for a bus and transfer to the subway. The distance between the consumer's residence and work is 12 miles. Automobile expenses are based on the federal government reimbursement rate of \$0.31 per mile for travel by private automobile. Parking is assumed to be provided by the employer. The wage rate for computing opportunity cost is \$10 per hour. One could think of the opportunity cost as the constraint of working 30 minutes less each day due to the longer bus ride.

¹⁵ The equation for computing the net present value is

$$NPV = I + \sum_{t=1}^3 \frac{S_t}{(1+d)^t}$$

¹⁶ The conclusion would not change if the finance charge were much greater. For example, if the borrower paid a \$20 fee per \$100 (a 520% annual percentage rate), the net present value is still positive at \$5.38.

2-3 Cash flows for \$200 automobile repair (Dollars)

	<u>Day</u>	<u>Net cash flows</u>	<u>Discounted cash flows</u>
0	Tuesday	- 200.00	-200.00
1	Wednesday	4.56	4.51
2	Thursday	4.56	4.46
3	Friday	4.56	4.42
4	Saturday	0	0
5	Sunday	0	0
6	Monday	4.56	4.28
7	Tuesday	4.56	4.23
8	Wednesday	4.56	4.19
9	Thursday	4.56	4.14
10	Friday	4.56	4.10
11	Saturday	0	0
12	Sunday	0	0
13	Monday	4.56	3.97
14	Tuesday	204.56	176.24
	Total	45.60	14.55

Other assumptions might lead to different decisions. If the cost of repairing the automobile were \$400 instead of \$200, the net present value of obtaining a payday advance to finance the repair would be -\$13.14. Since this result is negative, use of a payday advance would be detrimental. Under these assumptions, financing the automobile repair using a payday advance would be more expensive than using public transport to commute to work until the consumer receives funds from his next check to pay for the repair.

These examples are hypothetical, of course. Benefits and costs will differ from case to case. Other examples clearly are conceivable. It is difficult to generalize when numerous transaction-specific calculations are possible. Nevertheless, concluding that there are cases in which consumers' savings could exceed the cost of a payday advance seems entirely reasonable.¹⁷

Calculations such as those discussed above are sufficient to make decisions if the consumer has no alternative but to delay expenditures until the next payday. In some cases, however, consumers may have alternative sources for short-term borrowing.

¹⁷ These examples do not include non-pecuniary benefits, such as avoiding the risk of writing a bad check, maintaining a record of timely payments, or enjoying the comfort of commuting in one's own automobile. Non-pecuniary benefits may have value to the consumer. In principle, this value could be included in a net present value calculation.

Evaluating Availability of Alternatives

Consumers with alternative sources for short-term borrowing should evaluate these sources in the same way that they evaluate the payday advance transaction—comparing the investment outlay with the present value of savings, using the cost of source for the discount rate in the present value calculation. In evaluating alternative sources for financing, one needs to consider a few characteristics of consumers' financial behavior that may cause the nominal and subjective costs of alternatives to diverge. These characteristics involve the precautionary motive for saving and the use of financial contracts to enforce budgetary discipline.

First, subjective yields on liquid asset holdings tend to be high because precautionary motives for saving are strong. Many consumers use liquid assets grudgingly even when events occur that impair their earning potential or require large expenditures. Their reluctance to use liquid assets stems from a belief that the worse the current situation, the greater is the need to maintain reserves for future emergencies (Katona [1975]).¹⁸ As a consequence, subjective yields on liquid assets are often substantially greater than nominal yields. This characteristic of consumers' financial behavior may explain consumers' simultaneous holding of consumer debt and relatively large amounts of liquid assets. The weighted average annual percentage rate on the outstanding consumer credit is greater than the nominal yield but less than the subjective yield on the liquid assets. Since consumers who have personal loans from finance companies or credit card debt also hold liquid assets, the subjective yield on liquid assets is likely to be quite high for some consumers.

Second, consumers may use consumer credit rather than draw against their liquid assets because they believe that they do not have the discipline to replenish the depleted assets.¹⁹ The credit contract forces the borrower to budget his money, saving via the debt repayment rather than fritter future income on the numerous goods and services that are available in the market. This practice is costly, but there is considerable evidence that many consumers are willing to pay to be protected against their own bad habits (Juster and Shay [1964]; Katona [1975]). Consumers have also used other types of contractual arrangements—for example, whole life insurance, lay-away plans, and Christmas club accounts—to force themselves to budget their money. It seems likely some consumers use payday advance credit to perform a similar mandatory budgeting service.

Third, considerations that affect consumers' use of liquid assets may influence their use of credit cards. Unused credit limits on credit cards are an asset against which some consumers

¹⁸ Consumers' response to accelerating inflation provides an example of the strength of consumers' precautionary motive for saving. With the recognition of the accelerating inflation, consumers added to their liquid assets, even though the yields available to them on savings were less than the rate of inflation. In making their decisions the uncertainty associated with inflationary economy outweighed the loss in value of their assets. See Katona [1973].

¹⁹ Closed-end credit imposes greater discipline than open-end credit because closed-end credit provides a fixed schedule for repayment and does not allow further extensions of debt. As noted below, some consumers are reluctant to use open-end credit because they believe they do not have the discipline to repay the debt.

may be reluctant to borrow.²⁰ Recent evidence suggests that consumers maintain target levels of unused credit limits (Gross and Souleles [2000]; Bird and Hagstrom [2000]). One interpretation for this behavior is that consumers hold some precautionary assets in the form of unused credit limits. The subjective cost of borrowing beyond the target levels would be greater than the nominal interest rate. In addition, some consumers may be reluctant to increase credit card debt because they fear that they will not have the discipline to make payments on the additional debt (Katona [1975]). Using payday advances as a contractual obligation to enforce budgetary discipline may be costly, but perhaps less costly than the exposure of increased vulnerability to higher debt levels over the long run.

²⁰ Most consumers recognize the value of a credit card for an emergency. Anyone having experienced a car breakdown or a medical emergency on a trip knows it can be extremely difficult to acquire the needed service without one.

CHAPTER 3

SURVEY OF PAYDAY ADVANCE CUSTOMERS

Information on consumer's use of payday advance credit has been limited mainly to anecdotes and individual companies' marketing studies. Broadly, representative data have been largely unavailable. PricewaterhouseCoopers [2001] surveyed payday advance companies to obtain primarily transactional data but also limited information on customers' demographic characteristics. The data on customer demographics were very limited because few items are collected on a consistent basis across companies.

Many questions about payday advance customers cannot be answered with data from company records. The number of times in a year a consumer uses payday advances from all companies, the availability of alternatives for short-term borrowing, or his understanding of payday advance terms, for example, can only be obtained from consumer surveys. Such information is crucial for understanding consumers' decisions to use payday advances. Understanding consumers' decisions is important for payday advance companies in designing products to meet the needs of their customers and for public policy makers in choosing appropriate regulatory policies.

The lack of comprehensive information about consumers' decisions to use payday advances motivated the survey of payday advance borrowers conducted for this study. This chapter discusses the objectives, target population, and the methodology of the survey.

Survey Objectives

Over and over, policy discussions of the payday advance industry have raised several fundamental issues about consumers' use of payday advances that could not adequately be addressed with existing data. The issues ultimately involve consumers' decision-making processes. The issues include

- What circumstances lead consumers to take out payday advances?
- Are payday advance customers aware of the cost and terms of the product?
- What alternatives do payday advance customers have for obtaining short-term credit?
- To what extent do payday advance customers shop among different sources for short-term credit? Why do they choose payday advances over other sources of credit?
- Do payday advance customers use payday advances for relatively short periods of time, or do they have payday advances outstanding over a large part of the year?
- To what extent are consumers satisfied with their experiences with payday advance credit?
- When problems do occur, what are the reasons for problems, and how are they resolved?

These issues underlie the development of the questionnaire. Where possible, questions were borrowed from other financial surveys (the Federal Reserve Board's Survey of Consumer Finances and the Survey Research Center's Survey of Consumer Attitudes) to facilitate comparison of payday advance customers with the general population. The questionnaire is provided in appendix B.

Target Population

The target population for the survey is recent customers of companies belonging to the industry trade association, the Community Financial Services Association of America (CFSA). As mentioned in chapter 1, the association has over 60 member companies operating approximately 5,000 offices, which is about half of the 10,000 estimated offices providing similar short-term loans nationwide. A sample based on this target population is representative only of customers of CFSA-member companies. It is not necessarily representative of all payday advance customers. Nevertheless, this target population was chosen because options for sampling from the population of all payday advance customers were prohibitively expensive or had other significant disadvantages.

One option for selecting a nationally representative sample would be to draw a random sample of households with telephones and screen household members for use of payday advances. The advantage of this option is that the sample would be representative of all payday advance customers, not just customers of CFSA-member firms. The disadvantage of this option is that it would be very expensive because of the low frequency of payday advance use in the general population.²¹

A second option for selecting a nationally representative sample would be to draw a random or systematic sample of customers from the files of all payday advance companies. This option would substantially reduce the number of consumers who must be sampled in order to obtain a target sample size. In principle, this option would be representative of all payday advance customers. However, there are practical difficulties. No comprehensive list of payday advance companies exists. Constructing a list from files maintained by state licensing agencies would be time consuming and probably incomplete, since states do not license payday advance companies uniformly. Moreover, even if an adequate list could be constructed, companies may not be willing to participate. Significant refusal of companies to participate would undermine the overall representativeness of the sample, which is the principle advantage of this option.

Selecting a sample of customers of CFSA-member companies has several advantages. A list of member companies exists, and the association was willing to make considerable effort to encourage member companies to cooperate. Thus, coverage of the target population was likely to be good. While not necessarily representative of the population of all payday advance customers, this target population comprises the majority of payday advance customers. It is possible that customers of CFSA-member companies may have different experiences than customers of nonmember companies. For example, because the association's "Best Practices" may set higher standards of conduct for members, customers of member companies may have fewer problems and express greater satisfaction than customers of nonmember companies. Still, findings from the CFSA-member company sample are useful because they reflect experiences and knowledge of customers of companies adhering to a specific set of standards. And to the

²¹ Results of a proprietary marketing study conducted for a major payday advance company suggest less than 10%, perhaps much less, of screened households have ever used payday advances.

extent that state laws coincide with the association's "Best Practices," the findings of this survey may be more broadly representative than the CFSA-member base.²²

Methodology

The survey was designed as a 15-minute telephone survey of approximately 500 payday advance customers of CFSA-member companies. The sample design, sample selection, and interviewing was performed by Market Facts, a national market research firm.

Sample Design and Selection

The sample was drawn from CFSA-member companies. A two-stage proportionate sample design was used to ensure appropriate representation by large, mid-sized, and small companies. Size was determined by number of retail offices operated by each company. The original 19 companies were selected with a probability proportionate to the number of offices. Each selected company then submitted a listing of all its offices. The appropriate number of offices, proportionate with the company's size, was randomly selected from within each organization. These selected offices, 78 in total, then submitted a list with names, addresses, and phone numbers of all individuals who had taken out a payday advance during the past six months. Seventy customers from each office were randomly selected for participation in the survey, yielding an initial sample size of 5,460.

To manage the sample and reduce response bias, ten equal replicates of 546 customer listings were formed. Each replicate served as a microcosm of the universe. Each included seven randomly selected customers from the 78 offices. As interviewing progressed, the replicates would be gradually released. Up to two attempts per day and at least nine attempts in total were planned for each phone number. The goal was to maximize the number of attempts on one replicate before proceeding to the next replicate.

Prior to interviewing, a search program identified duplicate phone numbers within and across replicates, uncovering 96 in total. In some cases, two or more adults from the same household had applied for a payday advance. In other cases, one individual had applied for an advance at two different companies. For duplicate phone numbers, one listing was eliminated, leaving a final sample of 5,364 eligible customers.

Interviewing

The survey was conducted between December 28, 2000 and January 9, 2001. Of the 5,430 sampled customers, 1,274 customers (23.8%) could not be contacted because the telephone number was not valid (table 3-1). A total of 1,894 customers (35.3% of sampled customers) were not available during the interview period, mostly because the customer was not at home when called during the 12-day period over which interviews were conducted. Interviewing during the holiday season and the very short interview period contributed to the large number of

²² Some of the association's standards are requirements of state payday advance laws. See discussion of the regulatory environment for payday advance credit in chapter 1.

customers not available. Interviews were attempted for 2,196 (40.9%) of the 5,364 sampled customers.

3-1 Survey Response

(Number of sampled customers)

Number not valid

Disconnected number	1,113
Business or wrong number	161
Subtotal	1,274

Not available for interviewing during interview period

Not at home	1,451
Appointment scheduled	130
Communication difficulty	122
No answer, busy, answering machine, fax, modem	191
Subtotal	1,894

Interview attempted

Completed interview	427
Payday advance not acknowledged	726
Quit interview	185
Refused interview	858
Subtotal	2,196

Total **5,364**

Of customers with whom interviews were attempted, 427 (19.9%) completed interviews. Once interviewing began, some customers quit interviews. Most respondents quitting interviews quit in the first few questions asking about use of specific types of credit in the last year. By far the largest group of customers quitting early (726, or 33.1% of those with whom interviews were attempted) did so by not acknowledging they had used payday advances in the last year. It is likely that these customers were unwilling to answer financial questions and answered “no” to avoid further questions of this nature.²³ Finally, 858 customers (39.1% of those with whom interviews were attempted) refused to be interviewed. The number of refusals likely is higher than it ordinarily would be because of the short interview period. Had time permitted, refusals

²³ A subsample of those refusing to acknowledge use of payday advance credit was asked about use of selected types of credit, income, and demographic characteristics. The percentage of these consumers acknowledging use of mortgage credit was about the same as that for respondents, but percentages acknowledging use of other types of credit or reporting income were considerably less than those for respondents. Refusals to questions about demographic characteristics were negligible, however, and distributions of these customers’ demographic characteristics were quite similar to those of respondents.

would have been recontacted by interviewers specialized in converting refusals. It is likely some would have responded in the end.

For customers who completed interviews, the quality of responses was very good. These customers provided answers for virtually all factual questions.²⁴ Reported values were generally reasonable, and missing values were inconsequential to the analyses.

²⁴ “Don’t know” responses were considered acceptable for questions about attitudes and awareness of the price of payday advance credit.

CHAPTER 4

FRAMEWORK FOR ANALYSIS

The standard economic analysis of consumer behavior focuses on the outcome of decisions. This analysis uses a utility optimization model together with data on product choices, prices, consumer income, and perhaps consumers' demographic characteristics to estimate the responsiveness of decisions to differences in prices and income. Such analyses have been highly successful in predicting outcomes, but they often provide little insight on the decision process.

To understand the consumer decision processes, many researchers have used buyer-behavior models, which are based on research in marketing and psychology (Engel, Blackwell, and Miniard [1997]). The acquisition, understanding, and use of information play important roles in this process.²⁵ Thus, this framework is a useful supplement to the standard economic model for analysis of payday advance use since customers' awareness of costs, comprehension of the product, and consideration of alternatives are important concerns.

The Buyer-Behavior Model

The buyer-behavior model views the consumer's decision as a process occurring over several stages: problem recognition, internal and external search, alternative evaluation, purchase, and outcome evaluation. These stages are interrelated, with feedback occurring throughout the process. Developments occurring during each stage may cause the process to stop, move to the next stage, or proceed immediately to the purchase. Consideration of this process suggests several hypotheses about the ways in which consumers use payday advances.

Problem Recognition

The decision process begins with problem recognition. For example, a consumer foresees a shortfall of cash before he receives his next paycheck. He perceives the problem to be sufficiently serious to warrant further action and is not aware of any external constraints that preclude further action. The consumer might view the cash shortage as potentially costly in out-of-pocket expenses (such as fees or late payments or overdrawing a checking account) or delay in obtaining a product or service (such as delaying the repair of an automobile used to drive to work). An external constraint might be a belief by the consumer that he would be unable to arrange a loan soon enough to avoid the problem.

²⁵ For this reason, the buyer-behavior model has provided an especially useful framework for assessing regulatory policies in the consumer credit area, many of which address perceived information difficulties faced by consumers (for example, see Day and Brandt [1973], or more recently, Durkin and Elliehausen [2001]).

Internal Search

Once the consumer recognizes the problem and perceives no external constraints, he must then assess the alternatives for action. The assessment begins with a search of stored information and experience. Relying on past experiences, the consumer uses existing attitudes to identify and evaluate alternative solutions to the problem. One of three outcomes is likely. First, if the past experiences produced satisfactory results, the consumer may forgo external search and proceed to the purchase stage. In the cash shortage example, a consumer who previously used payday advances and was satisfied with the experience might decide to obtain another payday advance without further search. Second, if the internal search leads the consumer to believe the problem cannot be solved, the decision process may stop. For example, a consumer whose credit applications have previously been turned down may take no further action because he believes he cannot obtain credit. Third, if a consumer decides that he needs further information, he may search externally. For example, a consumer may recall having seen an advertisement by a cash advance company and decide to call or visit the company.

External Search and Alternative Evaluation

In this stage of the decision-making process, the consumer uses various sources of external information, such as the mass media (e.g., newspapers and magazines), personal sources (e.g., friends and relatives), and seller-dominated sources (e.g., advertisements and store visits). Before undertaking external search, the consumer may have little or no awareness of the characteristics of available brands or the advantages and limitations of the brands. The consumer may not even know appropriate criteria to use in evaluating alternatives.²⁶ External search will continue until the consumer believes he has enough information to make a purchase decision.

Consumers differ in their willingness to search. Personal characteristics, attitudes, and previous experience influence willingness to search. Some consumers are cautious and will search for additional information even when they already have considerable knowledge about alternatives. Other consumers may dislike shopping and will not search very much even if they risk paying too much or not obtaining the preferred set of product characteristics.

No matter how disposed a consumer is toward shopping, the willingness to search is limited. Search requires time and energy. At some point, the time and energy required for further search outweigh any expected gains from additional information. The consumer is then ready to make a purchase decision.

Purchase and Outcome Evaluation

The purchase decision involves choosing whether or not to acquire the good or service and choosing the variety (i.e., the specific set of characteristics) and supplier. The decision

²⁶ Evaluative criteria are the product characteristics that the consumer deems to be important in his choice of alternatives. Evaluative criteria are shaped by personality and by stored information and experience. Obviously, a consumer must have some knowledge of the class of alternatives before specifying those characteristics that are important in decision making.

process does not necessarily end with the purchase, however. Consumers may continue to process information to evaluate their decisions. An evaluation of the outcome is especially likely when the decision process has been extended. Satisfaction with the purchase decision serves to reinforce existing attitudes and the evaluative criteria upon which they are based. Obviously, satisfaction tends to encourage repeat purchases. Dissatisfaction can lead to revisions in attitudes and a reevaluation of evaluative criteria. In this case, the consumer learns from experience and avoids similar mistakes in the future.

Information Processing in the Buyer-Behavior Model

Information processing occurs through a psychological command center, which includes both memory and the basic facilities for thinking and directing behavior. The components of the command center necessary for understanding behavior are the information and experience stored in memory, the criteria by which alternative choices are evaluated, and attitudes toward alternatives. Each component is affected by personality. These variables interact to form a filter through which incoming information is processed. The filter plays a critical role in information processing. First, the filter greatly limits the amount of information that comes to the consumer's attention. The filter also may attenuate or distort information to be more consistent with the consumer's attitudes. Finally, the filter limits the amount of information that is retained in memory.

The operation of the filter has important consequences for the evaluation of payday advance use. The consumer must first become aware of the information. The creditor must provide easy access to information, but awareness also depends on the consumer's attitudes and evaluative criteria. A consumer may not become aware of some product characteristics if the characteristics are not important to him. He may focus only on the characteristics that are important to him, especially if the product has many characteristics. Most payday advance customers are likely to be aware of payday advance characteristics because it is a fairly simple product.

A consumer may be aware of information but not comprehend the information correctly. It is common for information to be attenuated and distorted to be consistent with the individual's own attitudes and experiences. For example, add-on interest rates rather than actuarial rates were commonly disclosed before Truth in Lending. In studies of consumer responses to Truth in Lending shortly after the law became effective, many borrowers recalling annual percentage rates appeared to understand the annual percentage rate as an add-on rate (e.g., Shay and Schober [1973]; Brandt, Day and Deutscher [1975]). This understanding probably reflected consumers' familiarity with add-on rates at that time.²⁷ Considering that payday advance costs are often expressed as a dollar amount per \$100 borrowed and that cost comparisons are typically made using finance charges, it would not be surprising to find interest rates for payday advances to be understood as add-on rates, despite required disclosure of annual percentage rates.

²⁷ More recently, Durkin and Elliehausen [2001] reported that borrowers still do not understand the relationship between the annual percentage rate and finance charge. However, far fewer responses suggest that the borrowers understand the annual percentage rate as an add-on rate. One explanation for this decline is that consumers are no longer familiar with add-on rates because creditors no longer quote add-on rates.

Not all information that is processed is retained in memory. Memory is limited, so the amount of information finally stored will be less than the initial set. Consumers tend to retain the information that is consistent with their attitudes and experience. First-time customers of a product might collect more information than previous customers because they do not know what information is important. New customers will tend to retain the information that is consistent with their experiences. Inconsistent information is irrelevant and will tend to be forgotten. Thus, new borrowers sometimes appear to be better informed than more experienced borrowers.

Determinants of the Extent of the Decision Process

Empirical evidence on consumer behavior suggests several different types of factors that may affect the extent of the decision process. They are situational factors, product characteristics, consumer characteristics, and environmental factors. These types of factors suggest different hypotheses about the extent of the decision process for payday advances.

Situational Factors

Previous research has found several situations in which extended decision processes are likely. Among the situations are ones in which

- The consumer has little or no relevant experience because a consumer has never purchased the product.
- The consumer has no past experience because the product is new.
- Past experience is obsolete because the product is purchased infrequently.
- The purchase is considered discretionary rather than necessary.

These situational factors suggest a few hypotheses about payday advance customers. New payday advance customers may be more likely than long-time customers to consider other sources for short-term credit. Infrequent payday advance customers may be more likely than frequent payday advance customers to consider other sources. And customers using payday advances for planned expenses may be more likely to consider other sources than customers using payday advances for unexpected expenses.

Product Characteristics

There are several product characteristics that are associated with extended decision processes.

- Products that commit the consumer for a long period of time.
- Products that are high priced relative to the consumer's income.
- Products having substitutes with both desirable and undesirable characteristics relative to the product.

For most consumers, the term to maturity and the cost of payday advances probably would not motivate extended decision processes. The effect of consumers' evaluations of substitutes on the

decision process is unclear in many cases. Some payday advance customers, however, will have few alternatives making the possibility of an extended decision process unlikely.

Consumer Characteristics

Evidence indicates that many socio-economic characteristics of consumers are correlated with the extent of the decision process. Some of the characteristics probably reflect cognitive ability and the opportunity cost associated with search. Others may reflect experience or attitudes. Decision processes are more likely to be extended than limited when

- The consumer has a college education.
- The consumer has moderate rather than high or low income.
- The consumer is under 35 years old.
- The consumer enjoys shopping.
- The consumer perceives no urgent or immediate need for the product.

Profiles of payday advance customers in the existing literature indicate that payday advance customers tend to belong to the middle class (Community Financial Services Association [2000]). As such, their socio-economic characteristics would suggest they would not fall in especially extended or limited decision-process groups. However, considering the situations in which payday advances are used, payday advance customers are likely to perceive an immediate need for the product. This characteristic, which is associated with limited decision processes, is likely to dominate other customer characteristics.

Environmental Factors

Environmental factors include family and cultural influences. An extended decision process may be stimulated by differences between a consumer's attitudes and those of his family or one of his reference groups. Thus, consideration of personal characteristics may be justified, even if the characteristics' effects on the decision process cannot always be predicted.

CHAPTER 5

SURVEY RESULTS

The discussion of survey results is organized into five main sections. The sections cover (1) the characteristics of payday advance customers, (2) payday advance customers' attitudes toward credit and payday advance credit, (3) customer experiences with payday advance credit, (4) availability of alternatives to payday advance credit, and (5) an analysis of the customer's most recent payday advance decision.

Characteristics of Payday Advance Customers

The characteristics of payday advance customers are best interpreted when measured against a benchmark. This section compares selected characteristics of payday advance customers and compares the distributions of these characteristics with those for the general population of adults. The characteristics selected are those that previous research indicates influence consumers' credit decisions. This section also compares distributions of characteristics of payday advance customers with bank card holders who use the revolving credit feature of the account.²⁸ Bank card revolvers are of interest because bank cards can be viewed as the established, mainstream credit product that allows borrowing of relatively small amounts quickly and conveniently.

Family Income

Payday advance customers predominately have moderate incomes. Over half of payday advance customers have family incomes between \$25,000 and \$49,999. This fraction is considerably larger than the two-fifths of all adults that have incomes between \$25,000 and \$49,999 (table 5-1). Payday advance customers are less likely than the general population to have either low or higher incomes. The requirement that payday advance customers have a checking account likely reduces the number of low-income consumers who are potential payday advance customers. Higher income consumers are less likely than moderate-income families to find use of payday advance credit advantageous because of higher income families' substantially greater holdings of liquid assets and access to credit.²⁹

The distribution of income of bank card revolvers differs markedly from that of payday advance customers. Forty-five percent of bank card revolvers have incomes of \$50,000 or more, compared to 25.4% of payday advance customers. Only about a third of bank card revolvers are

²⁸ Bank card holders were asked: "Thinking about your general purpose credit card(s) that give you the option of paying part of the balance each month [i.e., bank cards], would you say that you almost always, sometimes, or hardly ever pay off the total balance in full each month? Revolvers are respondents who reported sometimes or hardly ever paying off the total balance in full each month.

²⁹ The benchmark surveys are the University of Michigan Survey Research Center January 2000 Survey of Consumer Attitudes (see Durkin [2000]) and the Federal Reserve Board's 1998 Survey of Consumer Finances (see Kennickell, Starr-McCluer, and Surette [2000]). Statistics reported in this monograph may differ from ones reported elsewhere because sample weights were modified to reflect the population of adults rather than households.

in the moderate-income group, an income group in which most payday advance customers are found. The percentage of bank card revolvers in the low-income group, 20.4%, is not much lower than the percentage of payday advance customers in the low-income group. This difference in the income distributions suggests that bank cards and payday advances may not be substitutes for many consumers.³⁰

5-1 Family income^a

(Percent)	Payday advance customers	Bank card revolvers ^b	All adults ^b
Less than \$25,000	23.0	20.4	31.5
\$25,000-49,999	51.5	34.5	29.0
\$50,000 or more	25.4	45.1	39.6
Total	100.0	100.0	100.0

^a The percentages in the tables of this report may not total 100 percent due to rounding.

^b Source: January 2000 Survey of Consumer Attitudes.

Age, Marital Status, and Family Life-Cycle Stage

Payday advance customers are disproportionately young. Two-thirds of payday advance customers are under 45 years of age, and 36.4% are under 35 years of age (table 5-2). In contrast, only about half of all adults are under 45, and 28.7% are under 35. Relatively few payday advance customers are old. One in ten payday advance customers is age 55 or older, compared to over three in ten of all adults being 55 or older.

Like payday advance customers, bank card revolvers are younger than the adult population. However, bank card revolvers are older than payday advance customers. Nearly two in ten bank card revolvers are 55 or older, while one in ten payday advance customers is 55 or older. The finding that payday advance customers and bank card revolvers are relatively young is consistent with hypotheses about consumer credit use. Consumers in early life-cycle stages tend to have high demand for credit. That payday advance customers are younger than bank card revolvers suggests that payday advances may not be substitutes for many customers.

³⁰ Payday advance customers have higher incomes than pawnbroker customers (see Johnson and Johnson [1998]). This difference in customer profiles suggests that payday advance companies and pawnbrokers may serve different market segments. It is noteworthy that like the small loan companies in the nineteenth century, payday advance companies cater largely to a moderate-income clientele, not the predominately low-income clientele of the pawnbrokers.

5-2 Age

(Percent)	Payday advance customers	Bank card revolvers ^a	All adults ^a
Less than 35 years	36.4	32.8	28.7
35-44 years	31.9	23.6	22.5
45-54 years	21.7	24.0	17.3
55-64 years	6.5	10.6	12.0
Over 65 years	3.5	9.0	19.5
Total	100.0	100.0	100.0

^a Source: January 2000 Survey of Consumer Attitudes.

The majority of payday advance customers are married or living with a partner, as are the majority of bank card revolvers and all adults (table 5-3). The noteworthy differences in the distribution of payday advance customers and those of bank card revolvers and the adult population are in the percentages of divorced or separated group and the widowed group. Payday advance customers are relatively more likely to be divorced or separated and less likely to be widowed. The lower percentage of widowed customers is explained largely by age. The higher percentage of divorced and separated customers reflects financial difficulties of single parent families, which becomes apparent when life-cycle stage is considered.

5-3 Marital status

	Payday advance customers	Bank card revolvers ^a	All adults ^a
Never married	16.8	15.3	16.3
Married or living with partner	57.9	62.9	60.9
Divorced or separated	23.0	15.2	13.8
Widowed	2.4	6.7	9.1
Total	100.0	100.0	100.0

^a Source: January 2000 Survey of Consumer Attitudes.

Life-cycle stage includes consideration of age, marital status, and the presence of children under 18 in the household (table 5-4). Payday advance customers are predominately found in two groups. The first group consists of consumers under age 45 who are married and have children (35.2% of payday advance customers). The second group consists of consumers of any age who are unmarried and have children (23.3% of payday advance customers). These two groups account for nearly three of five of all payday advance customers. In comparison, these same groups account for smaller proportions of bank card revolvers (about two in five) and adults (less than two in five).

The first group—consisting of consumers under age 45 who are married and have children—represents an early life-cycle stage, in which returns on investment in household durables are likely to be large. Many consumers in this group will not yet have reached their peak earning years, nor will they have accumulated large amounts of liquid assets. Thus, this

group is likely to contain many “rationed” borrowers, whose demand for credit is insensitive to annual percentage rates. The relatively high percentage of payday advance customers in this group, therefore, is consistent with these hypotheses.

The second group—consumers of any age who are unmarried and have children—generally represents an early life-cycle stage, despite the lack of an age restriction. Again, returns on investment on household durables are likely to be large, and consumers in this group will not yet have reached their peak earning years or accumulated large amounts of liquid assets. Consumers in this group may have even more limited resources than consumers under 45 who are married and have children. Families with unmarried heads and children may have difficulty increasing income by working more and often have high expenses because of the need for child care. Because such families are likely to be “rationed” in the Juster and Shay [1964] analytical framework, the relatively high percentage of payday advance borrowers belonging to this group is an expected result.

5-4 Life-cycle stage

(Percent)	Payday advance customers	Bank card revolvers ^a	All adults ^a
<i>Under age 45</i>			
Unmarried, without children	11.1	12.7	11.8
Married, without children	7.2	7.8	8.0
Married, with children	35.2	25.5	22.0
<i>Age 45 or older</i>			
Unmarried, without children	8.9	9.9	14.9
Married, without children	9.4	21.2	24.9
Married, with children	5.0	8.2	6.0
<i>Any age</i>			
Unmarried, with children	23.3	14.7	12.4
Total	100.0	100.0	100.0

^a Source: January 2000 Survey of Consumer Attitudes.

Income and Family Life-Cycle Stage

Table 5-5 tabulates consumer characteristics by both income and life-cycle stage. The results show that payday advance customers are disproportionately from moderate-income families in early life-cycle stages. Such consumers would generally fall in Juster and Shay’s rationed category. Moderate-income families in early life cycle stages account for 39.7% of payday advance borrowers but only 16.6% of the adult population. It is also notable that consumers from moderate-income families in early life-cycle stages are not especially frequent bank card revolvers. Despite their high demand for credit, consumers from such families account for just 20.4% of bank card revolvers, a percentage that is not much larger than the percentage of such consumers in the adult population.

Low and higher income consumers from families in early life-cycle stages are common among payday advance customers, but not disproportionately so. The percentage of payday

advance customers who are from low-income families in early life-cycle stages (17.4%) is not much different from that of the adult population (16.9%). And the percentage of customers from higher income families in early life-cycle stages (18.7%) is only a little lower than the percentage of such consumers from the adult population (22.1%).

Among consumers with low and higher incomes, those in later life-cycle stages are smaller percentages of payday advance customers than of the adult population. The percentage for low-income customers is likely lower because of both lower demand and lower income. Low-income consumers in later life-cycle stages also are proportionately less frequent among bank card revolvers than the general population. In contrast, the percentage of higher income consumers in later life-cycle stages is likely lower because of lower demand. High-income consumers in later life-cycle stages also are proportionately more frequent among bank card revolvers than the general population.

5-5 Income and life-cycle stage

(Percent)	Payday advance customers	Bank card revolvers ^a	All adults ^a
<i>Income less than \$25,000</i>			
Under age 45; or any age, unmarried, with children	17.4	14.6	16.9
Age 45 or older, excluding unmarried, with children	5.7	5.8	14.6
<i>Income \$25,000-49,999</i>			
Under age 45; or any age, unmarried, with children	39.7	20.4	16.6
Age 45 or older, excluding unmarried, with children	12.4	14.1	12.1
<i>Income \$50,000 or more</i>			
Under age 45; or any age, unmarried, with children	18.7	25.4	22.1
Age 45 or older, excluding unmarried, with children	6.1	19.6	17.6
Total	100.0	100.0	100.0

^a Source: January 2000 Survey of Consumer Attitudes.

Education

The education of payday advance customers is of interest because higher education levels have been associated with extended purchase decision processes and greater search. Education provides an indication of analytic skills, which may focus evaluative criteria more precisely and make information collection and processing more efficient. Education is also important because a low level of education, particularly less than a high school diploma, is often associated with a lack of knowledge of credit costs or other credit terms (Durkin and Elliehausen [1978]).

Consumers who lack knowledge about credit and are predisposed to avoid search may be vulnerable to credit decisions that are not economically rational.

Payday advance customers are concentrated in the middle levels of educational achievement. Thirty-eight percent of payday advance customers have high school diplomas, and 36.1% have some college (table 5-6). The percentage of payday advance customers with high school diplomas is slightly higher than the 34.3% of the adult population with high school diplomas. But the percentage of payday advance customers with some college (36.1%) is nearly one and a half times greater than the 21.1% of adults with some college. These groups are not as predisposed to search, nor are they as aware of credit costs as college graduates. However, available evidence indicates that some do shop for credit, and most can be considered aware of credit costs (Durkin and Elliehausen [1978]).

Payday advance companies do not have very many customers with low levels of education. Just 6.2% of payday advance customers do not have a high school diploma. This percentage is lower than the percentage of adults with no high school diploma (9.7%) and only slightly higher than the percentage of bank card revolvers with no high school diploma (3.7%).

5-6 Education (Percent)	Payday advance customers	Bank card revolvers ^a	All adults ^a
No high school diploma	6.2	3.7	9.7
High school diploma	38.3	29.7	34.3
Some college	36.1	28.2	21.1
College degree	19.4	38.5	34.9
Total	100.0	100.0	100.0

^a Source: January 2000 Survey of Consumer Attitudes.

Attitudes Toward Credit and Payday Advances

Attitudes reflect consumers' assessments of alternatives to satisfy needs as expressed in their evaluative criteria. These assessments are based on experiences stored in memory. As such, attitudes play a focal role in the purchase decision process. Nearly all payday advance customers (91.6%) also use other types of consumer credit. Sixty-two percent use bank or retail credit cards, 79.2% use closed-end consumer credit. Thus, payday advance customers' attitudes toward credit reflect considerable experience with different types of credit and creditors.

Attitudes Toward Credit

Payday advance customers generally view credit favorably. When asked whether they agree with the statement, "Most people benefit from the use of credit," 82.3% of payday advance customers either strongly agreed or somewhat agreed (table 5-7). Eleven percent disagreed somewhat, and only 6.8% disagreed strongly that credit helps most consumers.

Most payday advance customers do not believe that credit causes overspending. Seventy-nine percent of payday advance customers strongly agreed or somewhat agreed with the statement, “Overspending is the fault of consumers, not lenders.” Twelve percent of payday advance customers disagreed somewhat with this statement, and 8.2% of payday advance customers disagreed strongly. These results suggest that a large majority of payday advance customers do not feel they are victims of creditors’ frequent solicitations and easy credit standards. They believe that consumers bear responsibility for their own spending.

5-7 Attitudes toward credit (Percent)

	Strongly agree	Somewhat agree	Somewhat disagree	Strongly disagree	Don’t know	Total
Most people benefit from the use of credit.	40.1	42.2	10.5	6.8	.5	100.0
Overspending is the fault of consumers, not lenders.	56.2	23.0	11.7	8.2	.9	100.0
There is too much credit available today.	31.9	22.3	17.6	26.2	2.1	100.0
The government should limit the interest rates that lenders can charge even if it means that fewer consumers will be able to get credit.	38.2	33.7	13.8	11.5	2.8	100.0

A little more than half of payday advance customers strongly agreed or somewhat agreed with the statement, “There is too much credit available today.” Thus, some of the payday advance customers who believed that most consumers benefit from the use of credit and were responsible for their own spending also believed that creditors should grant credit less freely. They may believe that other consumers who do not use credit wisely would be helped if creditors did not grant credit as freely. Perhaps this attitude was influenced by the views of many journalists, politicians, and consumerists, who have criticized creditors’ numerous solicitations for credit cards and their extension of credit to subprime consumers.

A similar ambivalence regarding credit was observed by Durkin [2000] in a study of attitudes toward credit cards. Durkin found that a large majority of bank card holders believed bank cards provided a useful service and were satisfied with their own experiences with credit card companies. However, many of the same credit card holders expressed little confidence in other consumers’ use of bank cards or in the credit card companies’ behavior: “When they imagine the ‘other guy’ in contact with card issuers, whose behavior is already suspect, they imagine possible negative consequences, for example, excessive credit use (p. 630).” Apparently such views are common.

Considerable evidence supports the proposition that low interest rate ceilings restrict the availability of credit to consumers who pose a high risk or desire only small amounts of credit (see Staten and Johnson [1995]). Nearly three-fourths of payday advance customers agreed with the statement that the government should limit interest rates even if the limitations caused fewer consumers to be able to get credit. This attitude also suggests ambivalence toward creditors by a large percentage of payday advance borrowers. They are satisfied with their own experiences, but they are generally suspicious of creditors' pricing behavior.

Attitudes Toward Payday Advances

Customers have very favorable attitudes toward payday advance companies. Ninety-two percent of customers strongly agreed or somewhat agreed with the statement, "Payday advance companies provide a useful service to consumers" (table 5-8). This percentage is about ten percentage points greater than the percentage of customers who viewed credit as beneficial to most consumers. Three percent of customers somewhat disagreed that payday advance companies provide a useful service, and only 4.7% strongly disagreed. The overwhelmingly favorable response to this statement strongly suggests that payday advance companies serve a real economic need for their customers.

5-8 Attitudes toward payday advances

(Percent)

	<u>Strongly agree</u>	<u>Somewhat agree</u>	<u>Somewhat disagree</u>	<u>Strongly disagree</u>	<u>Don't know</u>	Total
Payday advance companies provide a useful service to consumers.	53.9	38.2	2.8	4.7	.5	100.0
The government should limit the number of payday advances I can get in a year.	17.1	12.4	18.7	50.4	1.4	100.0
The government should limit the number of times a payday advance can be renewed without a break.	19.7	16.6	18.7	42.9	2.1	100.0
The government should limit the fees charged by payday advance companies.	55.5	19.7	11.5	11.9	1.4	100.0

Payday advance customers were asked about their attitudes toward regulating different aspects of the payday advance transaction. As discussed in an earlier chapter, some critics of the industry argue that many consumers become addicted to payday advances, eventually using such credit as long-term financing. One proposed remedy to this supposed problem would be to limit the number of payday advances a consumer can take out in a year. When asked about such a

limitation, over two-thirds of payday advance customers strongly disagreed or somewhat disagreed. Twelve percent of payday advance customers somewhat agreed that the number of payday advances in a year should be limited, and 17.1% strongly agreed.

Another proposed remedy to prevent long-term use of payday advance credit would limit the number of times a payday advance can be renewed without a break. Responses to this proposal were similar to the previous one. Sixty-two percent of payday advance borrowers strongly disagreed or somewhat disagreed that the number of consecutive renewals should be limited. Seventeen percent of payday advance borrowers somewhat agreed that the number of consecutive advances should be limited, and 19.7% strongly agreed.

Pricing is another aspect of payday advances that is regulated. Customers were asked whether the government should limit the fees charged by payday advance companies. Three of four payday advance customers strongly agreed or somewhat agreed with the statement that the government should regulate the fees charged by payday advance companies. Considering the very favorable attitude toward payday advances and opposition to limiting the number of payday advances, it is likely that few of these payday advance customers would agree with limits that would prevent them from obtaining payday advances. Instead, this attitude favoring price regulation would seem to reflect a general feeling that prices are high and a lack of understanding of competition in a market economy. Such feelings are not unique to payday advances. Durkin [2000], for example, found that bank card holders expressed vague feelings that bank card interest rates were high.

Perceptions of the Cost of Payday Advances

Payday advance companies often promote their product as being less expensive than fees for returned checks or late payments. Fees vary considerably across financial institutions, however.³¹ Thus, one customer's experience may differ greatly from that of another. To obtain information on perceptions of costs, customers were asked whether in their opinion the cost of payday advances is higher than, about the same, or lower than the cost of selected fees. The fees considered are fees for returned checks, late fees on rent or mortgage payments, and late fees for credit card or other debt payments.

Forty-four percent of payday advance customers said the cost of payday advances is greater than fees for returned checks (table 5-9). About half said the cost of payday advances is the same as or less than fees for returned checks. Only 6.6% of payday advance customers said that they did not know. One cannot check survey responses against actual fees, but it is likely that most of these payday advance customers are knowledgeable. Sixty-eight percent had written checks that were returned for insufficient funds in the last year and likely would have remembered the return check fee. Thus, many customers may have used payday advances to avoid returned checks because of the lower cost. Many more customers may have used payday advance to avoid returned checks despite equal or higher cost. That these customers wished to avoid the stigma of returned checks despite the cost is understandable.

³¹ For data on bank fees, see Hannan [2001].

5-9 Cost of payday advances (Percent)

<i>Cost of payday advance relative to cost of ...</i>	<u>Higher</u>	<u>Same</u>	<u>Lower</u>	<u>Don't know</u>	<u>Total</u>
Returned check fees	43.6	27.6	22.3	6.6	100.0
Late fees on rent or mortgage	40.8	22.0	21.6	15.7	100.0
Late fees on credit card or other consumer debt	33.5	29.0	24.4	13.1	100.0

Large percentages of customers believe payday advances are also more costly than late fees. Forty-one percent of customers said the cost of payday advances is more than late fees on rent or mortgage payments, and 33.5% said the cost of payday advances is more than late fees on credit card or other consumer debt. Percentages of customers who said that they did not know were considerably higher than for returned check fees. Nevertheless, by far most customers did have perceptions of the cost of payday advances relative to late fees. Whether these customers did not know because they did not incur late fees or because of some other reason cannot be determined. Customers were not asked whether they actually incurred late fees recently.

In sum, large percentages of payday advance customers had perceptions that the cost of payday advances was greater than fees for returned checks and late payments. By a ratio of almost 2 to 1, customers believe payday advances are more costly than these fees than believe they are less costly. Thus, perceptions that the cost of payday advance credit is relatively low would not generally predispose many payday advance customers to use such credit. Some may have used payday advance credit to avoid returned checks or late fees in spite of the higher cost.

Customer Experience with Payday Advance Credit

Most customers who recently obtained payday advances have not used payday advance credit for very long. About half (49.6%) of recent customers obtained their first payday advance in 2000, and another 30.4% obtained their first payday advance in 1999 (table 5-10). This finding may in large part be attributed to the rapid growth in the payday advance industry. However, other factors may also contribute to the explanation for the small percentage of long-term customers. Many customers may use payday advances because of unexpected expenses or temporary shortfalls in income. Over time, these consumers' financial condition may improve, reducing the need to resort to payday advance credit. Other consumers may become dissatisfied or find less expensive alternatives to payday advance credit. The extent to which these other factors affect the distribution cannot be ascertained from these data or from other sources.³²

³² Evidence on general consumer credit use suggests the hypothesis that some consumers' use of payday advance credit is temporary and short term is not implausible. Using panel data, Avery, Elliehausen, and Kennickell [1987] found only a small fraction of high debt payment-to-income families in 1983 had high debt payment burdens three years later. Recovery from temporary declines in income explained a large part in the shift in debt payments relative to income.

5-10 Year in which customers first obtained payday advances
(Percent)

2000	49.6
1999	30.5
1998	14.6
1997 or earlier	5.3
Total	100.0

Frequency and Duration of Payday Advance Use

The range in customer use of payday advances in the past twelve months is wide. At the lower end of use, a little more than a third of payday advance customers used a total of 1-2 advances or 3-4 advances, which includes both new advances and renewals (table 5-11). Renewals may be either a rollover, in which the customer renews the advance by paying only the finance charge, or a same-day advance, in which the customer takes out another advance on the same day that he repays an outstanding advance in full. At the high end, 22.5% of customers had a total of 14 or more payday advances in the last twelve months.

By far, most payday advance customers did not renew advances very often. A quarter of customers did not renew any payday advance in the previous twelve months, and 35.0% had 1-2 or 3-4 renewals. Some payday advance customers did renew frequently, however. Nine percent of customers had 9 to 13 renewals in the last twelve months, and 10.4% had 14 or more renewals.

These usage statistics indicate a dichotomy in payday advance usage. A relatively large percentage of customers used advances quite infrequently. Assuming a two week average period for each payday advance, a little more than a third had advances outstanding a total of less than two months, and about half had advances outstanding less than 3 months. But an equally large percentage of customers had many advances during the year. The higher frequencies imply substantial periods of time over which payday advance credit is outstanding. Assuming a two-week average period for each payday advance, the highest frequency users (the 22.5% using more 14 or more advances) had payday advances outstanding over half of the year.

5-11 Total number advances, new advances, and renewals in the last 12 months
(Percent)

	Total advances	New advances	Renewals
None	n.a.	n.a.	25.1
1-2	15.6	35.5	21.1
3-4	19.2	31.4	13.9
5-6	16.9	15.3	10.4
7-8	10.3	7.0	9.6
9-13	15.6	6.7	9.4
14 or more	22.5	4.2	10.4
Total	100.0	100.0	100.0

n.a. Not applicable.

A dichotomy in payday advance usage is also apparent in the length of the longest consecutive sequence of payday advances outstanding. By far, most borrowers did not have long consecutive sequences of payday advances. The longest consecutive sequence of payday advances for 27.6% of customers was two weeks or less (table 5-12), and the longest sequence for another 29.0% of payday advance customers was 3 to 4 weeks. However, for some customers the longest sequences were greater than two months. Nine percent of payday advance customers had longest consecutive sequences of 9 to 13 weeks, and 10.0% had longest sequences of 14 or more weeks.

In sum, most customers use advances infrequently or moderately. Nearly four in five customers had advances outstanding in total less than half of the year. Generally, payday advances were used at different times over the year. Over half of customers' longest consecutive sequence of advances was less than a month. These findings suggest that many customers use payday advances regularly for short periods of time. Such use is consistent with the attitudes expressed by customers disagreeing with limits on the number of times a consumer can obtain payday advances during the year.

5-12 Length of longest sequence of consecutive advances in the last 12 months
(Percent)

Two weeks or less	27.6
3-4 weeks	29.0
5-6 weeks	10.4
7-8 weeks	14.5
9-13 weeks	8.6
14 or more weeks	10.0
Total	100.0

Use of Different Payday Advance Companies

Forty-seven percent of payday advance customers obtained advances from more than one company (table 5-13). Of the customers using more than one company, 63.7% used two payday advance companies, 23.6% used three payday companies, and 12.6% used four or more

companies. An important motive for using more than one payday advance company appears to be to extend the period of time over which the debt is outstanding. A little more than a third of payday advance customers who used more than one company obtained an advance at one company to pay-off an advance at another company at least once during the previous twelve months.

The remaining two-thirds used more than one company for other reasons. For example, some customers may use multiple payday advance companies sequentially like using different credit cards to increase the amount of debt or availability of credit (see Bizer and DeMarzo [1992]). Another example is that customers may use different companies because the location of each company may be convenient at different times.

5-13 Use of different payday advance companies in the last 12 months (Percent)

	Payday advance customers	Customers using more than one company
Used more than one company	47.0	100.0
<i>Number of companies used</i>		
Two	30.0	63.7
Three	11.1	23.6
Four or more	5.9	12.6
Total	47.0	100.0
Paid off one company with proceeds of payday advance from another company	16.5	35.2

Late Payments on Payday Advances

Because payday advances are often taken out to cover unexpected expenses, one would expect that borrowers would sometimes have problems repaying their advances on time.³³ Twenty-four percent of customers reported being late in repaying an advance in the last twelve months (table 5-14). A little more than half of late payers were past due just one time. The reported late payments for payday advances are *any* payments that are past due. They are not just late payments of 30, 60 or 90 days or more past due, which are reported in conventional delinquency statistics.³⁴ Considering the financial difficulties that may cause many consumers to use payday advance credit, it is notable that 75.9% of payday advance borrowers repaid exactly on time.

³³ Payday advance companies generally do not charge fees for late payments. Fees for late payments on payday advance credit are not usually authorized by payday advance statutes.

³⁴ Nevertheless, conventional delinquencies for credit other than payday advance credit can be substantial. For the second quarter of 2000, 10.40% of borrowers were currently 30 or more days past due on one or more credit accounts. For the same quarter, 50.35% of borrowers were 30 or more days past due on one or more credit accounts sometime in the previous four years. Source: Trans Union, LLC, *TrenData* database, second quarter 2000.

5-14 Late payments in the last 12 months

(Percent, unless otherwise noted)

Customers making payments late	24.1
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Number of times paid late

(Percent of late payers)

One time only	53.0
Two or more times	47.0
Total	100.0

Resolution of late payments

(Percent of late payers)

Treated fairly	83.8
Treated unfairly	14.1
Total	100.0

Reasons treated unfairly

(Number of responses)

Harassed	7
Threatened with criminal prosecution	5
Embarrassed in front of others	2
Not allowed to make partial payments	2
Inconvenienced because check was cashed	1
Other	2
Total	19

By far the greater part of payday advance customers who had late payments (83.8%) said the payday advance company treated them fairly in resolving the late payments. The number of late payers who said that they were treated unfairly is too small to permit a statistical analysis of the reasons.³⁵

Availability of Alternatives to Payday Advance Credit

Nearly all payday advance customers use credit other than payday advance credit. As mentioned earlier, 91.6% of payday advance customers also use some other type of consumer credit (table 5-15). The frequency of consumer credit use among payday advance customers is more than one-tenth greater than that among the adult population as a whole. Eighty-two percent of all adults use consumer credit. The higher incidence of consumers in early family life-cycle stages among payday advance borrowers than the adult population may explain in large part this difference in frequency of consumer credit use.

³⁵ Late payers who said that they were treated unfairly were asked how they were treated unfairly and read a list of reasons, which are listed in table 5-14 along with the frequency with which each reason was mentioned.

Payday advance customers differ from the adult population in the frequency of use of specific types of credit used. Payday advance customers are less likely than the adult population to use open-ended consumer credit. Fifty-seven percent of payday advance customers have bank cards compared to 72.5% of adults. And 21.5% of payday advance customers have retail cards compared to 56.8% of all adults. In contrast, payday advance customers are more likely than the adult population to use closed-end consumer credit. Slightly more than half of payday advance customers have automobile loans compared to 33.5% of the adult population and 36.6% of payday advance customers have other closed-end consumer debt compared to 21.4% of all adults.

5-15 Use of selected types of credit

(Percent)	Payday advance customers	All adults ^b
Any consumer credit ^a	91.6	82.4
<i>Open-end consumer credit</i>		
Bank cards	56.5	72.5
Retail cards	21.5	56.8
<i>Closed-end consumer credit</i>		
Auto loans	52.9	33.5
Other	36.6	21.4
<i>Mortgage credit</i>		
Mortgage	32.0	46.0
Home-equity line of credit	6.8	7.9

^a Includes non-revolving use of bank or retail card.

^b Sources: Bank cards, January 2000 Survey of Consumer Attitudes; other credit types, 1998 Survey of Consumer Finances.

Nearly a third of payday advance customers have mortgage debt. This percentage is less than the 46.0% of all adults having mortgage debt, but payday advance customers are also less likely than the adult population to own their homes (41.7% of payday advance customers and 66.3% of all adults). Surprisingly, considering their lower incidence of home ownership, payday advance customers have about the same incidence of home equity credit lines as the adult population.

Availability and Use of Bank Card Credit

Bank card holding and use is of particular interest because bank cards can be viewed as the established, mainstream credit product that allows borrowing of relatively small amounts quickly and conveniently. These attributes make bank cards a potential substitute for payday advance credit. As discussed earlier, users of bank card credit tend to be older and have higher incomes than payday advance customers, however. This finding suggests that bank cards may serve a different, perhaps less risky, market segment than payday advances.

Nevertheless, a little more than half of payday advance customers also have bank cards. These payday advance customers have somewhat fewer bank credit cards than bank card holders generally. Thirteen percent of payday advance customers have four or more bank card accounts, but 20.1% of all bank card holders have four or more bank card accounts (table 5-16). Since bank card accounts may be added sequentially to increase the amount of available credit (Bizer and DeMarzo [1992]), payday advance customers can be viewed as having more limited availability than bank card holders overall.

Payday advance customers revolve bank card balances more frequently than bank card holders generally. About a quarter of payday advance customers almost always pay bank card balances in full when they receive their monthly statements, and 54.6% hardly ever pay bank card balances in full. In contrast, 48.8% of bank card holders overall almost always pay their balances in full, and 30.4% hardly ever pay in full. Payday advance customers also borrow heavily against their credit limits. Sixty-one percent of payday advance customers said that they refrained from using a bank card in the past year because their credit limit would have been exceeded.³⁶ Thus, many of the payday advance customers who have bank cards may not be able to draw against their credit limits when they have unexpected expenses.

³⁶ This information is not available for all bank card holders. However a smaller percentage of bank card holders are likely to be constrained. Overall, 23.9% of bank card balances were utilized in the second quarter of 2000, and 52.4% of consumers with revolving accounts had a revolving account with greater than 50% utilization of the credit limit. Source: Trans Union, LLC, *TrenData* database, second quarter 2000.

5-16 Bank card ownership and use

(Percent of bank card holders, unless otherwise noted)

	Payday advance customers	All adults ^a
Has bank cards (Percent of all consumers)	56.5	72.5
<i>Number of bank card accounts</i>		
One	39.6	37.7
Two	33.5	29.3
Three	13.9	13.0
Four or more	13.0	20.1
<i>Payment practices on bank cards</i>		
Almost always pays full balance	25.1	48.8
Sometimes pays full balance	20.3	20.7
Hardly ever pays full balance	54.6	30.4
Refrained from using bank card in past year because credit limit would have been exceeded	60.8	n.a.
<i>Annual percentage rate on bank card used most frequently</i>		
Less than 7.50%	6.5	5.4
7.50-11.49%	7.8	12.9
11.50-14.49%	10.8	16.8
14.50-19.49%	36.2	41.0
19.5% or more	17.2	14.0
Don't know	21.6	10.0
Total	100.0	100.0

^a Source: January 2000 Survey of Consumer Attitudes.

Payday advance customers who have bank cards were asked the annual percentage rate on the bank card used most frequently.³⁷ Twenty-two percent of these customers said that they

³⁷ Because reported rates cannot be checked against actual rates, researchers have created the concept of “awareness zones” to assess consumer knowledge of annual percentage rates (see Durkin [2000]). If a consumer reports an annual percentage rate that is within a range of current market rates, the consumer is classified as aware. If the consumer reports a rate outside the range or answers “don’t know,” he is classified as unaware. Durkin [2000] used two awareness definitions. His narrow definition classifies consumers reporting rates under 7.9% or answering “don’t know,” as unaware. Since some accounts may currently have “teaser” rates below 7.9%, Durkin also considered a broad definition that classifies only consumers answering “don’t know” as unaware. Because responses in the payday advance customer survey were rounded to the nearest whole number, the cutoff point for low rates for this study is 7.5%.

did not know the annual percentage rate on the bank card used most frequently. Customers reporting low rates may also be unaware, although some low rates may be “teaser rates” and therefore accurate. Seven percent of customers reported rates below 7.5%. Thus, between 21.6% and 28.1% of payday advance customers having bank cards can be considered as unaware, and between 71.9% and 78.4% can be considered aware of the annual percentage rate on the card used most frequently. The proportion of payday advance customers being aware of bank card rates is less than the proportion of all bank card holders being aware of rates (84.6-90.0%). Nevertheless, payday advance customers are generally aware of bank card rates. This finding is largely consistent with the middle levels of educational achievement of payday advance customers.

Debt Payment Burdens of Payday Advance Customers

A little more than half of payday advance customers have monthly consumer debt payments that are less than 10% of their monthly before tax income (table 5-17). Another 19.9% have consumer debt payments between 10% and 19% of their monthly income. Therefore, the greater proportion of payday advance customers do not have especially high monthly payment obligations on their consumer debts. Nevertheless some customers did have high debt-payment burdens. Nearly two in five (18.5%) payday advance customers had consumer debt payment-to-income ratios of 30% or greater. This percentage is considerably higher than the percentage of all adults with high consumer debt payment-to-income ratios (5.3%). These findings indicate that payday advance customers tended to have higher debt-payment burdens than the general population. Considering the high frequency of other credit use by payday advance customers, payday advance credit is more likely to be a consequence than the major cause of their higher debt-payment burdens.

5-17 Monthly consumer debt payment-to-income ratios (Percent)

	Payday advance customers	All adults ^a
Less than 10%	52.7	74.5
10-19%	19.9	15.8
20-29%	8.9	4.5
30% or higher	18.5	5.3
Total	100.0	100.0

^a Source: 1998 Survey of Consumer Finances.

Credit Availability

To explore credit availability further, payday advance customers were asked whether they had applied for credit in the last five years and been turned down or offered less credit than the amount for which they had applied. Nearly three-fourths of payday advance customers responded that they had been turned down or limited (table 5-17). This percentage is over three times greater than the 21.8% of all adults who had been turned down and limited. Payday advance customers were also asked if they had considered applying for credit but changed their

mind because they thought they would be turned down. Two-thirds of payday advance customers responded affirmatively to this question. This percentage is nearly five times greater than the percentage of all adults who considered applying for credit but changed their mind because they thought they would be turned down. Clearly, payday advance customers perceive that they have difficulty obtaining credit, and their turndown experience is consistent with their perceptions.

5-18 Credit availability
(Percent)

	<u>Payday advance customers</u>	<u>All adults^a</u>
<i>In the last 5 years, ...</i>		
Consumer was turned down or not given as much credit as he applied for	73.0	21.8
Consumer considered applying for credit but changed his mind because he thought he would be turned down	67.7	14.3
Consumer borrowed cash by pawning something at a pawnshop	23.4	n.a.
Consumer filed for bankruptcy	15.4	3.7

^a Source: 1998 Survey of Consumer Finances.

Many payday advance customers have other characteristics associated with credit problems and limited credit availability. Nearly a quarter of payday advance customers borrowed from a pawnshop in the past five years. Fifteen percent filed for bankruptcy in the past five years, compared to 3.7% of all adults. Moreover, a quarter of payday advance customers were 60 or more days late on a mortgage or consumer debt payment in the last year, compared to 5.8% of adults overall (numbers not in table). And, as mentioned, payday advance customers' use of bank cards suggests high utilization of credit limits, a characteristic associated with greater credit risk.

The limitations in availability of credit from traditional creditors may also help explain customers' lack of awareness of annual percentage rates for payday advance credit, which is discussed in the next section. If other credit is not available, comparisons of annual percentage rates between payday advances and other types of credit would not affect the payday advance decision. Thus, the customer may not pay much attention to the annual percentage rate for a payday advance. And since the information would not be relevant, the customer would not tend to retain information on the annual percentage rate in memory.

Customers' Most Recent Payday Advance Transaction

The payday advance customer survey asked customers about their most recent payday advance transaction to gather information about the purpose of the advances, customers' awareness of fees and interest rates, and the frequency of search for alternatives to payday advance credit.

The Most Recent Payday Advance

The likelihood that recent customers will have an advance outstanding at any point in time varies according to seasonal factors. The December-January period during which the payday advance customer survey was conducted is a time of high demand for payday advances because of holiday expenses. About half (52.7%) of the recent customers had a payday advance outstanding at the time of the survey. The seasonal factor also may affect the purpose of the advance (a greater percentage of discretionary expenses than emergency expenses) and the distribution of new advances and renewals (a greater percentage of new advances than renewals). At the time of the survey, 32.2% of customers' most recent transactions were new advances, and 67.8% were renewals. The remainder of this section is concerned with the decision to obtain new advances and the initial advance in payday advance sequences involving renewals. These advances will be called the "most recent new advance."

The New Payday Advance Decision

The greater part of most recent new payday advances was obtained because of emergencies, mostly caused by unexpected expenses. Nearly half (47.2%) of most recent new advances were used to pay an unexpected expense, and 18.5% of advances were used to get through a temporary reduction in income (table 5-19). About a third of advances were discretionary.³⁸ Twelve percent of most recent new advances were used for planned expenses. The remaining 22.5% of advances were for other purposes.

5-19 Purpose of most recent new advance (Percent)

Emergencies

Unplanned expenses	47.2
Temporary income reduction	18.5

Discretionary uses

Planned expenses	11.9
Other	22.5
Total	100.0

³⁸ Planned and other expenses can be considered discretionary in that the need for the payment is generally known in advance and can be budgeted. Even if the advance is used for a necessity such as rent, the consumer chose to spend his income on other things rather than set aside sufficient funds to pay for the necessity.

State laws generally limit the maximum size of payday advances, with a little more than half of states limiting payday advances to \$500 or less (Community Financial Services Association [2000]). Although many states permit larger payday advances, practically all (97.8%) of most recent new advances were \$500 or less (table 5-20). The most common size range for payday advances is \$201-300. Forty-five percent of payday advances were in this range.

5-20 Size of most recent new advance
(Percent)

\$100 or less	7.0
\$101-200	27.3
\$201-300	45.4
\$301-400	8.9
\$401-500	9.2
More than \$500	2.2
Total	100.0

Information on cost is crucial for making rational decisions on payday advance use. Two measures of cost are disclosed in consumer credit transactions, the finance charge and the annual percentage rate. Payday advance customers were generally able to recall the finance charge. Ninety-six percent of payday advance borrowers reported a finance charge for their most recent payday advance (table 5-21). Only 4.3 percent of customers were unable to recall the finance charge.

To judge the accuracy of reported finance charges, reported amounts were converted to finance charge per \$100 advanced. This calculation facilitates comparisons across advances of different sizes. Of the customers reporting finance charges (second column of table 5-21), only 4.3% reported finance charges of less than \$10 per \$100 advanced. An amount less than \$10 per \$100 advanced may be too low to be an accurate statement of actual finance charges, suggesting that the customer may be unaware of the finance charge on the transaction. Thus, the remaining 95.7% of customers who reported a finance charge could be considered aware of the finance charge on their most recent new payday advance. It is notable that over half of the customers reporting a finance charge cited fees in the \$15-19 per \$100 range. Most state rate ceilings for payday advances and market rates in states without rate ceilings fall in this range (Community Financial Services Association [2000]).

5-21 Finance charge per \$100 advanced for most recent new advance
(Percent)

	All customers	Customers reporting finance charge
Less than \$10	4.1	4.3
\$10-11	6.5	6.8
\$12-14	9.4	9.8
\$15-19	49.8	52.0
\$20-24	20.0	20.9
\$25 or more	6.0	6.3
Don't know	4.3	n.a.
Total	100.0	100.0

The second measure of cost that customers receive is the annual percentage rate. Seventy-eight percent of payday advance customers recalled receiving information on the annual percentage rate for their most recent new advance (number not in table). However, few customers recalling receipt of annual percentage rate information knew the rate that was disclosed. Only 20.1% of these customers reported an annual percentage rate. Seventy-two percent did not know what rate was disclosed (number not in table).

Of the payday advance customers reporting rates, fewer than half reported rates that are consistent with the range of actual market annual percentage rates for payday advances. Twenty-one percent reported rates in the 200-399% range, and 18.3% reported rates in the 400-599% range (table 5-22). A surprisingly large percentage reported annual percentage rates below 30%. An examination of the finance charges reported for annual percentage rates under 30% suggests that a large percentage of customers reporting rates under 30% were providing an add-on rate (i.e., the finance charge as a percentage of the advance amount).³⁹

5-22 Annual percentage rate for most recent new advance
(Percent)

	Customers reporting annual percentage rate
Less than 30%	40.8
30-199%	15.8
200-399%	20.8
400-599%	18.3
600% or higher	4.2
Don't know	n.a.
Total	100.0

³⁹ Reported annual percentage rates and computed add-on rates were within three percentage points of each other for 19 of the 49 customers reporting annual percentage rates under 30%. Many of the rates were exactly equal, but allowing a small discrepancy is warranted because survey respondents often round numbers rather than make an effort to recall exact numbers.

These results indicate nearly all payday advance customers are aware of the finance charges for their most recent new payday advance, but few customers can recall annual percentage rates. Customers' awareness of the finance charge suggests that this measure of cost is useful and relevant to them. They can readily compare the finance charge for a payday advance with the late fees or other costs they would incur if they do not obtain credit. They can also compare the finance charge for a payday advance with the finance charge for other types of credit, although such a comparison would be incorrect.⁴⁰

In contrast, the lack of awareness of annual percentage rates suggests that annual percentage rate may not be very useful to payday advance customers. Late fees or other costs that would be saved are not normally expressed as annual percentage rates. Annual percentage rates are, of course, available for other types of credit. However, payday advance customers typically have the characteristics of Juster and Shay's [1964] "rationed" consumers. They cannot obtain as much credit as they desire from traditional creditors, and their limited holdings of liquid assets make borrowing from themselves expensive. Thus, consumers may not retain information about annual percentage rates for payday advances. As pointed out in chapter 4, consumers filter information, storing useful information in memory and discarding irrelevant information.

Payday advance customers were asked about the availability of funds in their checking and savings accounts at the time of the most recent new advance. Eighty-four percent reported not having enough funds in their accounts (number not in table). This response suggests that payday advance customers' liquid assets were indeed very limited. Remember that nearly two-thirds of customers obtained payday advances between \$101 and \$300 (table 5-20). Such small amounts suggest that even for the 16.3% of payday advance customers who had sufficient funds in their accounts, liquid assets were very limited.

Despite payday advance customers' perceptions that other sources of credit were unavailable and evidence that these customers indeed faced limitations, many customers did consider other sources for credit before obtaining their most recent new advance. Thirty-eight percent of customers considered sources other than payday advance companies for obtaining the cash (number not in table). As shown in table 5-23, most of these customers considered depository institutions, banks (48.5%) or credit unions (15.5%).⁴¹ This consideration is perhaps natural because all payday advance customers must also have an existing relationship with a depository institution (i.e., they have a checking account, which is required to qualify for an advance). Thirty percent of customers considered finance companies. This consideration is also natural since personal loans at finance companies have historically been the marginal source of credit for rationed borrowers. Although half of customers have credit cards, few (6.2%) considered credit card companies. This source may not have been available for many customers because they had already borrowed heavily against their limits.

⁴⁰ The finance charge is an undiscounted sum of interest payments, making comparisons of finance charges over different periods of time invalid. For example, a 24-month loan with a 10% annual percentage rate has a smaller finance charge than a 36-month loan with a 10% annual percentage rate, even though the cost (10% per annum) is the same.

⁴¹ Forty-nine percent of payday advance customers are members of a credit union. Thus, 31.9% of payday advance customers eligible for a credit union loan considered such credit instead of a payday advance.

Only a few customers considered fringe market lenders. Three percent of payday advance customers considered auto title loan companies before obtaining their most recent new advance, and 0.6% considered pawnbrokers. Lack of familiarity does not explain the very low incidence of these sources as alternatives to payday advances. Nearly a quarter of payday advance customers have used pawnbrokers in the past five years (table 5-18), and 12.3% used automobile title loan companies in the last year (number not in tables). Many more customers may have heard of pawnbrokers and title loan companies. Instead, it is likely that payday advance customers do not consider these other sources for small, short-term loans as close substitutes for payday advance credit.

5-23 Consideration of other credit sources before obtaining the most recent new advance
(Percent)

	Customers considering <u>other sources</u>
Considered source other than payday advance company	100.0
<i>Other sources considered^a</i>	
Bank	48.5
Credit union	15.5
Finance company	29.8
Credit card company	6.2
Auto title loan company	2.5
Pawn shop	.6
Friend or relative	5.0
Other	8.7
<i>Most important reason for choosing payday advance over another source</i>	
Quick easy process, fast approval, less paper work	59.0
More convenient location	10.9
Advance is short term	2.6
Advance provides more privacy, not included in credit history	9.0
Advance less expensive	3.9
No other alternative	6.4
Other	7.1
Total	100.0

^a Sum is greater than 100% because some customers mentioned more than one item.

Nearly three in five payday advance customers who considered other alternatives cited the quick and easy process for obtaining the money as the most important reason for choosing a

payday advance over other sources. Another 10.9% cited the convenient location of the payday advance company as the most important reason. Since payday advance customers have considerable experience with consumer credit, their prior knowledge may have allowed them to limit the decision process. For many, consideration of search costs may have been sufficient reason to choose a payday advance over another source of credit.

Credit availability was the most important consideration for a small percentage of customers who considered other sources of credit. Nine percent of those considering other sources mentioned privacy or lack of credit reporting as the most important reason for choosing a payday advance. Six percent stated explicitly that in the end, no other sources of credit were available. Various other reasons were mentioned for choosing a payday advance over another source of credit. It is notable that few customers choose payday advances because of cost. Only 3.9% of customers cited cost as the most important reason for choosing a payday advance over another source.

By far most payday advance customers were satisfied with their most recent new advance. Forty-two percent of customers were very satisfied with their most recent new advance, and 33.0% were somewhat satisfied (table 5-24). Twelve percent of customers were dissatisfied, about half of whom were very dissatisfied.

5-24 Satisfaction with most recent new advance
(Percent)

Very satisfied	42.2
Somewhat satisfied	33.0
Neither satisfied nor dissatisfied	12.5
Somewhat dissatisfied	6.3
Very dissatisfied	5.9
Total	100.0

Reasons for dissatisfaction
(Percent of customers very
or somewhat disappointed)

High interest rate	30.8
High finance charge	9.6
High cost, not ascertained whether finance charge or interest rate	21.2
Collection problems	7.7
Insufficient or unclear information	3.9
Not able to renew or extend	3.9
Too difficult to get out of debt	1.9
Other	21.2
Total	100.0

Dissatisfied customers were asked the reason for their dissatisfaction. High cost was overwhelmingly the reason for customers' dissatisfaction. A high interest rate was the most

frequently mentioned reason, with 30.8% of dissatisfied customers mentioning this reason. A high finance charge or just high cost was also frequently cited (9.6% and 21.2%, respectively). In total, 61.6% of dissatisfied customers mentioned some aspect of cost as a reason for dissatisfaction. Other specific problems were infrequent. Collection problems were mentioned by 7.7% percent of dissatisfied customers. Insufficient or unclear information was mentioned by 3.9% of respondents. And only 1.9 percent of dissatisfied customers mentioned difficulty in being able to get out of debt as the reason for their dissatisfaction.

CHAPTER 6

SUMMARY AND CONCLUSIONS

The payday advance transaction is a consumer credit transaction. As such, a standard economic model of consumer credit use is applicable for analysis of payday advance use. The model compares the expenditure financed by credit with the present value of benefits resulting from the expenditure. The interest rate for the payday advance is the discount rate for computing the net present value. Use of a payday advance is advantageous if the net present value of the transaction is positive.

Using such a framework for analysis of consumers' credit decisions, previous research (Juster and Shay [1964]) classified consumers into one of two broad groups based on their willingness to forgo current consumption to build equity in consumer durable assets being financed by credit. Borrowers who are not constrained by equity requirements were classified as "unrationed." These borrowers have relatively high levels of liquid assets and discretionary income. Their demand for credit is sensitive to interest rates.

Borrowers who are constrained by equity requirements are classified as "rationed." They have limited discretionary income and liquid assets, making sacrifices in current consumption or precautionary savings costly. Borrowers not wishing to forgo current consumption can sometimes obtain additional credit by using unsecured personal credit, but this credit is riskier and therefore more costly than other forms of credit. These borrowers' demand for credit is not sensitive to interest rates. For many borrowers, additional unsecured personal credit is available only from specialized high-risk lenders at a substantially higher cost. Traditionally, finance companies provided this type of credit. Payday advance companies also provide such credit.

Survey of Payday Advance Customers

With this theoretical framework in mind, a survey was developed to answer the following questions about payday advance customers' demand for credit:

- What circumstances lead consumers to take out payday advances?
- Are payday advance customers aware of the cost and terms of the product?
- What alternatives do payday advance customers have for obtaining short-term credit?
- To what extent do payday advance customers shop among different sources for short-term credit? Why do they choose payday advances over other sources of credit?
- Do customers use payday advances for relatively short periods of time, or do they have payday advances outstanding over a large part of the year?
- To what extent are consumers satisfied with their experiences with payday advance credit?
- When problems do occur, what are the reasons for problems?

A nationally representative sample of customers of payday advance companies belonging to the industry trade association, The Community Financial Services Association of America, was selected. Customers were surveyed between December 28, 2000 and January 9, 2001.

Survey Findings

Characteristics of Payday Advance Customers

Survey results indicated that the characteristics of payday advance customers are consistent with predictions of the economic model of consumer credit choice. Payday advance consumers tend to be younger, married or unmarried with children under 18 years of age than the adult population. These characteristics reflect early stages of the family life-cycle and together with limited income characterize “rationed consumers,” whose demand for credit Juster and Shay [1964] hypothesized would be insensitive to interest rates. Thus, a large percentage of payday advance customers are from those groups for which use of high cost credit may be economically rational. This finding does not mean that any use of payday advances by these groups is rational or that use by other groups is not rational. It means simply that demographic patterns of payday advance use are consistent with economic theory.

Another noteworthy finding is that a relatively small percentage of payday advance customers have low income or low levels of education. Payday borrowers largely do not have profiles similar to the typical fringe banking customer. This result should not be surprising. The requirement that customers have a checking account prevents many low-income consumers from qualifying for a payday advance.

Attitudes toward Credit and Payday Advances

Payday advance customers have favorable attitudes toward payday advance credit and consumer credit in general. By far most customers believe that most people benefit from the use of credit and that payday advance companies provide a useful service. The majority of customers believe the government should limit the fees charged by payday advance companies. However, customers probably would not agree with limits that would prevent them personally from obtaining payday advances. Customers overwhelmingly disagreed with limitations to the number of consecutive payday advances and limitations to the number of payday advances in a year.

Many payday advance customers believe that advances are relatively expensive. A large percentage of customers thought the cost of payday advances was higher than fees for returned checks or late payments on debts. Some customers apparently use payday advance credit to avoid fees of returned checks or late payments in spite of its perceived high cost.

Customer Experience with Payday Advance Credit

By far most customers did not obtain very many payday advances during the year, nor did they have any sequence of consecutive advances outstanding very long. About half of customers had advances outstanding less than a total of three months during the year, and nearly four in five had advances outstanding less than half of the year. Generally, payday advances were used at different times over the year. Over half of customers' longest consecutive sequence of advances was less than a month. These findings belie the view that payday advance credit puts many consumers in a cycle of debt from which they cannot escape. Nevertheless, some

consumers may have problems. A small percentage of customers did have a very large number of payday advances, which implied that they had advances outstanding more than half of the year. However, responses to other questions suggest the difficulty of getting out of debt was not perceived as a very common problem.

Nearly half of all payday advance customers used more than one company in the last year. A little more than a third of customers using more than one company used the proceeds of an advance from one company to pay off an advance at another company. Almost two-thirds used more than one company for other reasons.

Almost a quarter of payday advance customers repaid an advance later than the due date in the last year. By far the greater proportion of those paying late said the payday advance company treated them fairly in resolving the late payments, a result that is consistent with the very high level of favorable attitudes toward payday advances.

Availability of Alternatives to Payday Advance Credit

Nearly all payday advance customers use credit other than payday advances. They are more likely to use credit than adults in the population, but they are less likely to have revolving credit. Although most payday advance customers have low to moderate levels of monthly consumer debt payments relative to their monthly incomes, their debt payments to income tend to be higher than those of the adult population. Payday advance customers' high use of credit may in large part reflect the early family life-cycle stages of many of these customers. About one in five payday advance customers has high consumer debt payments to income, a proportion that is much higher than the proportion of high debt payments to income for all adults. However, considering the high frequency of other credit use by payday advance customers, payday advance credit is more likely to be a consequence than the major cause of their higher debt-payment burdens.

By far the greater proportion of payday advance customers had experienced credit turndowns and also had refrained from applying for credit because a turndown was expected. Payday advance customers are less likely than all adults to have bank cards, but payday advance customers who do have bank cards are more likely to revolve balances than all bank card holders. Among payday advance customers who have bank cards, most have utilized their credit limits to the extent that they have been constrained from further borrowing at least once during the last year. And a quarter of payday advance customers have had delinquencies of 60 days or more during the last year. These characteristics suggest that most payday advance customers likely have few alternatives to using payday advance credit. These customers are indeed "rationed" and likely to be insensitive to annual percentage rates.

The Most Recent Payday Advance

Nearly all payday advance customers were aware of the finance charge for their most recent payday advance. Although most remembered receiving information on the annual percentage rate, few could recall accurately what annual percentage rate was disclosed. Apparently, the annual percentage rate was not sufficiently useful to warrant retaining the

information in memory. The lack of awareness of the annual percentage rate for payday advances contrasts sharply with payday advance customers' awareness of annual percentage rates for the bank card used most frequently. The greater proportion of payday advance customers with bank cards are generally aware of bank card rates, even though many of these customers may be "rationed" and would not be expected to be very sensitive to annual percentage rates. Recall also that a large percentage of customers believe that payday advance credit is relatively costly. These findings suggest that despite the lack of awareness of annual percentage rates for payday advances, customers are aware of the cost of advances. Therefore, most customers are not misled as to the high cost of advances.

A large percentage of payday advance customers considered obtaining funds from sources other than payday advances companies. The sources considered were generally traditional creditors, depository institutions and finance companies, but not very often credit card companies. Although the quick and easy process for obtaining the money was the most frequently cited reason for choosing a payday advance, credit availability likely influenced the decision. Payday advance customers' experience with credit turndowns, late payments, and high bank card utilization suggests that many of these customers would have had difficulty obtaining credit from traditional creditors. This conclusion is supported by the frequent use of payday advance credit by some customers.

Finally, three-fourths of customers are satisfied with their most recent new advance. The 12.2% of customers who were somewhat or very dissatisfied said that high cost was the reason for their dissatisfaction. Payday advance credit is expensive, and this response is consistent with earlier conclusions that customers are aware of the cost. Notably, insufficient information and difficulty of getting out of debt are not among the frequently mentioned reasons for dissatisfaction.

Conclusions

The survey evidence indicates that most customers use payday advance credit as a short-term source of financing. They used payday advances a small or moderate number of times during the past year, typically for less than a month at a time. Nearly all customers are aware of the finance charge for payday advance credit, but not the annual percentage rate. Payday advance customers use other types of consumer credit and are likely aware of annual percentage rates for such credit. However, they may have difficulty obtaining additional credit from traditional creditors, especially on an unsecured basis. Thus, payday advances give these consumers a little control over their financial situations that they otherwise would not have. This may explain customers' positive attitudes toward payday advance credit and high levels of satisfaction.

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APPENDIX A

COMMUNITY FINANCIAL SERVICES ASSOCIATION OF AMERICA “BEST PRACTICES”

Best Practices for the Payday Advance Industry

To be a member in good standing of CFSA, a payday advance provider must abide by the following best practices:

1. **Full disclosure.** A member will comply with the disclosure requirements of the State in which the payday advance office is located and with Federal disclosure requirements including the Federal Truth in Lending Act. A contract between a member and the customer must fully outline the terms of the payday advance transaction. Members agree to disclose the cost of the service fee both as a dollar amount and as an annual percentage rate (“APR”).
2. **Compliance.** A member will comply with all applicable laws. A member will not charge a fee or rate for a payday advance that is not authorized by State or Federal law.
3. **Truthful advertising.** A member will not advertise the payday advance service in any false, misleading, or deceptive manner.
4. **Encourage consumer responsibility.** A member will implement procedures to inform consumers of the intended use of the payday advance service. These procedures will include notifying consumers that a payday advance is a short-term cash flow tool not designed as a solution for longer term financial problems and informing customers of the availability of credit counseling services.
5. **Rollovers.** A member will comply with State laws on rollovers (the extension of an outstanding advance by payment of only a fee). In States where rollovers are not specifically allowed a member will not under any circumstances allow a customer to do a rollover. In the few States where rollovers are permitted, a member will limit rollovers to four (4) or the State limit, whichever is less.
6. **Right to rescind.** A member will give its customers the right to rescind, at no cost, a payday advance transaction on or before the close of the following business day.
7. **Appropriate collection practices.** A member must collect past due accounts in a professional, fair and lawful manner. A member will not use unlawful threats, intimidation, or harassment to collect accounts. CFSA believes that the collection limitations contained in the Fair Debt Collection Practices Act (FDCPA) should guide a member’s practice in this area.
8. **No criminal action.** A member will not threaten or pursue criminal action against a customer as a result of the customer’s check being returned unpaid or the customer’s account not being paid.
9. **Enforcement.** A member will participate in self-policing of the industry. A member will be expected to report violations of these Best Practices to CFSA, which will investigate the matter and take appropriate action. Each member company agrees to maintain and post its own toll-free consumer hotline number in each of its outlets.
10. **Support balanced legislation.** A member will work with State legislators and regulators to support responsible legislation of the payday advance industry that incorporates these Best Practices.
11. **Relationships with financial institutions.** A member may market and service payday advances made by a federally insured financial institution, provided the financial institution does the following: (1) sets its own credit criteria; (2) approves and funds each advance; (3) complies with State disclosure requirements, where not inconsistent with Federal law; (4) complies with State law as to the number of rollovers; (5) permits the member to purchase no more than a *de minimis* amount of the advances, or any such other amount which may be consistent with safety and soundness determinations by Federal banking regulators; and (6) complies with these Best Practices.

APPENDIX B

QUESTIONNAIRE

(IF FEMALE NAME ASK FOR FEMALE HEAD OF HOUSEHOLD)

(IF MALE NAME ASK FOR MALE HEAD OF HOUSEHOLD)

Hello, my name is _____, from TELENATION. I am calling for the Credit Research Center at Georgetown University. May I speak to the (female/male) head of your household?

- A. We are talking to men and women around the country today about different types of loans and credit. In the last 12 MONTHS, did you take out or make payments on (READ LIST)

	<u>YES</u>	<u>NO</u>	<u>DK</u>	<u>REF</u>
1 = A home mortgage loan	1	2	8	9
2 = A car loan	1	2	8	9
3 = A payday advance loan	1	2	8	9 (IF NO/DK/REF, THANK & TERM)
4 = A car title loan	1	2	8	9
5 = A home equity line of credit	1	2	8	9

INTERVIEWER CLARIFICATIONS AND HELP SHEET

Who/What is TELENATION?

TELENATION is a copyrighted name used by a national consumer survey research organization known as Market Facts.

How did you get my name/number?

Your telephone number was chosen randomly to be part of a representative sample of people using specific types of credit.

What is the Credit Research Center?

The Credit Research Center is an academic research center devoted to studying the economics of consumer and mortgage credit markets.

What/Where is the Georgetown University?

Georgetown University is a private school located at Washington DC.

What is a Payday Advance?

It is a short-term loan that you pay back on your next payday also known as payday loans or cash advances.

A. Attitudes toward Credit and Lenders

First, we are interested in your opinions about credit and lenders in general. Please tell me whether you strongly agree, agree somewhat, disagree somewhat, or strongly disagree with each of the following statements.

PROGRAMMER INSTRUCTIONS: RANDOMIZE ORDER FOR A1-A4

A1. Most people benefit from the use of credit.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

A2. Overspending is the fault of consumers, NOT lenders.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

A3. There is too much credit available today.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

A4. The government should limit the interest rates that lenders can charge even if it means fewer consumers will be able to get credit.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

You mentioned that you recently received a payday advance and we would like your opinions about payday advances. Please tell me whether you strongly agree, agree somewhat, disagree somewhat, or strongly disagree with each of the following statements.

PROGRAMMER INSTRUCTIONS: RANDOMIZE ORDER FOR A5-A8

A5. Payday advance companies provide a useful service for consumers.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

PROGRAMMER INSTRUCTIONS: ROTATE QA6a AND QA6b SO EACH RESPONDENT IS ASKED ONE QUESTION ONLY.

A6a. The government should limit the number of payday advances I can get in a year.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

A6b. The government should NOT limit the number of payday advances I can get in a year.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

PROGRAMMER INSTRUCTIONS: ROTATE QA7a AND QA7b SO EACH RESPONDENT IS ASKED ONE QUESTION ONLY

A7a. The government should limit the fees charged by payday advance companies.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

A7b. The government should NOT limit the fees charged by payday advance companies.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

PROGRAMMER INSTRUCTIONS: ROTATEQA8a AND QA8b SO EACH RESPONDENT IS ASKED ONE QUESTION ONLY.

A8a. The government should limit the number of times a payday advance can be renewed without a break.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

A8b. The government should NOT limit the number of times a payday advance can be renewed without a break.

4 = STRONGLY AGREE
3 = AGREE SOMEWHAT
2 = DISAGREE SOMEWHAT
1 = STRONGLY DISAGREE

.8 = DON'T KNOW
.9 = REFUSED

B. Most Recent Payday Advance

Now, we would like to ask you a few questions on your experiences with payday advances.

B1. Do you have a payday advance outstanding now?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

B2. Is your MOST RECENT payday advance a new advance or a renewal of a previous advance?

1 = NEW ADVANCE

GO TO B2a

2 = RENEWAL

GO TO B2b

.8 = DON'T KNOW

GO TO B3

.9 = REFUSED

GO TO B3

B2a. Did you take out this advance on the same day that you paid off an existing advance?

1 = YES

GO TO B2c

2 = NO

GO TO B2c

.8 = DON'T KNOW

GO TO B2c

.9 = REFUSED

GO TO B2c

B2b. Did you renew by paying only the fee or by paying off the old advance and taking out a new one on the same day?

1 = PAID ONLY THE FEE

2 = TOOK OUT NEW ADVANCE ON SAME DAY

.8 = DON'T KNOW

.9 = REFUSED

B2c. How many weeks have you had this payday advance outstanding without a break?

_____ WEEKS (RANGE 1-52)

.8 = DON'T KNOW

.9 = REFUSED

B3. What was the initial reason for getting the payday advance? Was it for ...(READ LIST)

- 1 = an unexpected expense,
- 2 = an expected expense,
- 3 = getting through a temporary reduction in income,
- 4 = or some other reason

.8 = DON'T KNOW

.9 = REFUSED

B4. In your MOST RECENT advance, what was the dollar amount you borrowed, not including the fee?

\$ _____ (RANGE 1-1,000)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

B5. What was the dollar amount of the fee you paid to get this advance?

\$ _____ (RANGE 1-220)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

B6. Were you given any information on the annual percentage rate of interest when you got this payday advance?

1 = YES

2 = NO

GO TO B8

.8 = DON'T KNOW

GO TO B8

.9 = REFUSED

GO TO B8

B7. What was the annual percentage rate of interest?

_____ % (RANGE 0-4,000)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

B8. Please think now about what a payday advance costs you. Which is more useful to you as a measure of the COST of a payday advance? Would you say the dollar amount of the fee or the annual percentage rate?

1 = DOLLAR AMOUNT OF FEE

2 = ANNUAL PERCENTAGE RATE

.8 = DON'T KNOW

.9 = REFUSED

B8a. Before you received your most recent payday advance, did you consider sources other than payday advance companies for borrowing the cash?

1 = YES

2 = NO

GO TO B11

.8 = DON'T KNOW

GO TO B11

.9 = REFUSED

GO TO B11

B9. What other sources did you consider? ... (DO NOT READ LIST. ACCEPT MULTIPLES)
Any other sources?

___ 1 = bank or savings and loan

___ 2 = car title loan

___ 3 = credit card company

___ 4 = credit union,

___ 5 = finance company,

___ 6 = loan from a friend or relative,

___ 7 = pawn shop,

___ 8 = or some other source

.8 = DON'T KNOW

.9 = REFUSED

B10. What was the MOST IMPORTANT reason for choosing a payday advance rather than another source?... (DO NOT READ LIST. ACCEPT ONE ANSWER ONLY)

- ___ 1 = a more convenient location,
- ___ 2 = greater privacy,
- ___ 3 = less paper work,
- ___ 4 = faster approval,
- ___ 5 = more respectful employees,
- ___ 6 = quick and easy process,
- ___ 7 = a short term or no revolving debt,
- ___ 8 = less harm to my credit,
- ___ 9 = less expensive than other sources for borrowing cash
- ___ 10 = no other alternative source for borrowing cash
- ___ 11 = some other reason

.8 = DON'T KNOW

.9 = REFUSED

B11. Did you have money in a checking or savings account that you could have used instead of taking out a payday advance?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

B12. Overall, how satisfied or dissatisfied are you with your experience with your most recent payday advance? Are you ...(READ LIST)

1 = very dissatisfied,

2 = somewhat dissatisfied,

3 = neither satisfied nor dissatisfied,

GO TO C1

4 = somewhat satisfied,

GO TO C1

5 = or very satisfied?

GO TO C1

.8 = DON'T KNOW

.9 = REFUSED

B13. What was the reason for being dissatisfied? (DO NOT READ, ACCEPT MULTIPLE RESPONSES)

1 = High cost (Not ascertained whether high fee or high interest rate)

2 = High interest rate

3 = High fee (dollar amount)

4 = Insufficient, not clear information

5 = Insufficient handling, collection of later payments

6 = Not able to borrow as much as requested

7 = Not able to renew or extend another payday advance

8 = Rude, discourteous, indifferent, or unfriendly service

9 = Too difficult to get out of debt

10 = Some other reason

.8 = DON'T KNOW

.9 REFUSED

C. Payday Advances in Last 12 Months

- C1. Let's talk in general about payday advances. In the last 12 MONTHS, how many times did you get a new payday advance?

_____ NUMBER (RANGE 0-99)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

- C2. In the last 12 MONTHS, how many times did you renew an existing payday advance by just paying the fee?

_____ NUMBER (RANGE 0-99)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

- C3. In the last 12 MONTHS, how many times did you take out a payday advance the same day you paid off another advance?

_____ NUMBER (RANGE 0-99)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

- C3. PROGRAMMER INSTRUCTIONS

___ 1 = R HAD ONLY ONE ADVANCE (C1 = 1) AND NO ROLLOVERS (C2 = 0) OR SAME-DAYS (C3 = 0). GO TO C10

___ 2 = R HAD ONLY ONE NEW ADVANCE , ALL SUBSEQUENT ADVANCES WERE ROLLOVERS (C1 = 1 AND C2 = 1+ AND C3 = 1+). GO TO C8

___ 3 = IF TWO OR MORE ADVANCES (C1 = 2+) CONTINUE TO QC4

C4. In the last 12 MONTHS, have you received payday advances from more than one company?

1 = YES

2 = NO

GO TO C8

.8 = DON'T KNOW

GO TO C8

.9 = REFUSED

GO TO C8

C5. In the last 12 MONTHS, how many different payday advance companies did you use?

_____ NUMBER (RANGE 0-9)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

C6. In the last 12 MONTHS, did you pay off an advance from one company by taking out an advance from another company?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

C7. In the last 12 MONTHS, what was the longest number of weeks that you had a payday advance outstanding without a break?

_____ WEEKS (RANGE 0-52)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

C7a. Is that sequence of payday advances still outstanding?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

C8. In the last 12 MONTHS, have you ever been late in paying back a payday advance?

1 = YES

2 = NO

GO TO C13

.8 = DON'T KNOW

GO TO C13

.9 = REFUSED

GO TO C13

C9. Were you late, (READ LIST)

1 = ONE TIME ONLY, OR

GO TO C11

2 = TWO OR MORE TIMES

GO TO C11

.8 = DON'T KNOW

GO TO C13

.9 = REFUSED

GO TO C13

C10. Did you pay off this payday advance as scheduled?

1 = YES

GO TO SECTION D

2 = NO

GO TO C11

.8 = DON'T KNOW

GO TO C13

.9 = REFUSED

GO TO C13

C11. When you were late, did the payday advance company treat you fairly or unfairly in resolving the late payment?

1 = FAIRLY

GO TO C13

2 = UNFAIRLY

.8 = DON'T KNOW

GO TO C13

.9 = REFUSED

GO TO C13

C12. In what way were you treated unfairly? Were you, (READ LIST. ACCEPT MULTIPLES. RANDOMIZE ORDER OF STATEMENTS)

___1 = threatened with criminal prosecution

___2 = embarrassed in front of others

___3 = inconvenienced because the check was cashed

___4 = not allowed to make partial payments

___5 = harassed

___6 = or treated unfairly in some other way

.8 = DON'T KNOW

.9 = REFUSED

C13. In what year did you first start using payday advances?

_____ YEAR (RANGE 1980-2000)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

D. Credit Experience and Availability of Alternatives

Now, I have a few questions about your experiences with other credit products.

- D1. Do you have any bank credit cards? These include Visa, MasterCard, Discover, and Optima cards?

1 = YES

2 = NO

GO TO D2

.8 = DON'T KNOW

GO TO D2

.9 = REFUSED

GO TO D2

- D1a. What is the total number of bank credit cards that you have?

_____ NUMBER (RANGE 0-10) IF "0" SKIP TO D2

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

- D1b. In the last 12 MONTHS, how often did you pay off your balance on your credit cards in full? Would you say that you ALMOST ALWAYS, SOMETIMES, or HARDLY EVER paid off the total balance in full

3 = ALMOST ALWAYS

2 = SOMETIMES

1 = HARDLY EVER

.8 = DON'T KNOW

.9 = REFUSED

- D1c. At any time In the last 12 MONTHS, were you unable to use your bank credit cards because you would have exceeded your credit limit?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

D1d. What is the annual percentage rate on the bank credit card you use most often?

_____ % (RANGE 0-40)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

D2. Do you have any store or gasoline company credit cards?

1 = YES

2 = NO

GO TO D3

.8 = DON'T KNOW

GO TO D3

.9 = REFUSED

GO TO D3

D2a. How many different store or gasoline credit cards do you have?

_____ NUMBER (RANGE 0-10)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

D3. Not counting the payday advance, mortgage, home equity, automobile, title or credit cards loans you already mentioned, did you make payments on any other loans In the past 12 MONTHS?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

D4. In the past 5 YEARS has a particular lender turned down any request you made for credit or not given you as much credit as you applied for?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

D5. Was there any time in the past 5 YEARS that you thought of applying for credit at a particular place but you changed your mind because you thought you might be turned down?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

D5a. Have you filed for bankruptcy in the past 5 YEARS?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

D6. In the past 5 YEARS, have you received cash by pawning something at a pawnshop?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

D7. Are you a member of a credit union?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

.

D8. People sometimes make mistakes. During the past 12 MONTHS, have you written any checks that have overdrawn a checking account?

1 = YES

2 = NO

GO TO D9

.8 = DON'T KNOW

GO TO D9

.9 = REFUSED

GO TO D9

D8a. In the past 12 MONTHS, how many checks have you written that have been returned because your account was overdrawn?

_____ NUMBER (RANGE 0-10)

.8 = DON'T KNOW

.9 = REFUSED

D9. In your opinion, is the cost of payday advances higher than, lower than, or about the same as the cost of ...(READ LIST)

	<u>Higher</u>	<u>Lower</u>	<u>Same</u>	<u>DK</u>	<u>REF</u>
1 = bouncing a check	1	2	3	.8	.9
2 = fees charged for late rent or mortgage payments	1	2	3	.8	.9
3 = fees charged for late credit card or other debt payments	1	2	3	.8	.9

E. Demographic Characteristics

PROGRAMMER INSTRUCTIONS:

___ 1 = IF R HAS A MORTGAGE OR HOME EQUITY LOAN (A=1 OR A=5) GO TO E1b

___ 2 = ALL OTHERS GO TO E1

E1. Do you own your home, rent, or have some other living arrangements?

1 = OWN

2 = RENT

7 = OTHER GO TO E1c

.8 = DON'T KNOW GO TO E1c

.9 = REFUSED GO TO E1c

E1b. How much is the monthly (mortgage/ rent) payment?

\$ _____

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

E1c. How long have you lived in your current residence? (READ LIST. ACCEPT ONE ANSWER ONLY)

1 = Less than 1 year

2 = 1 to less than 3 years

3 = 3 to less than 5 years

4 = 5 to less than 10 years

5 = 10 years or more

.8 = DON'T KNOW

.9 = REFUSED

PROGRAMMER INSTRUCTIONS:

___ 1 = R OWED CREDIT CARD OR OTHER DEBTS IN THE PAST 12 MONTHS

(A2=1 OR D1=1 OR D2=1 OR D3=1) GO TO E2a

___ 2 = ALL OTHERS GO TO E3

E2a. During the past 12 MONTHS, what was the average monthly dollar amount you needed to make payments on credit card and other non-mortgage debts?

_____ DOLLARS (RANGE 0-9,999)

PROBE: Can you give me an estimate?

.8 = DON'T KNOW

.9 = REFUSED

- E2b. During the past 12 months, have you ever been more than 60 days late in making payments on any mortgage or other debts?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

- E3. What is the month and year of your birth?

_____ MONTH / _____ YEAR (RANGE 1900-1982)

.8 = DON'T KNOW

.9 = REFUSED

- E4. What is the last level of education that you have completed? (DO NOT READ, ACCEPT ONE ANSWER ONLY)

___ 1 = Grade school or less

___ 2 = Some high school

___ 3 = High school graduate

___ 4 = Vocation/technical school

___ 5 = Some college

___ 6 = College graduate

___ 7 = Some postgraduate work

___ 8 = Postgraduate degree or more

___ .8 = DON'T KNOW

___ .9 = REFUSED

- E4a. How long have you been in your current job? (READ LIST. ACCEPT ONE ANSWER ONLY)

1 = Less than 1 year

2 = 1 to less than 3 years

3 = 3 to less than 5 years

4 = 5 to less than 10 years

5 = 10 years or more

.8 = DON'T KNOW

.9 = REFUSED

E4b. Are you currently on active military duty?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

E5. Are you currently (READ LIST)

___ 1 = MARRIED OR LIVING WITH PARTNER

___ 2 = SEPARATED

___ 3 = DIVORCED

___ 4 = WIDOWED

___ 5 = NEVER MARRIED

.8 = DON'T KNOW

.9 = REFUSED

E6. Are there any children under the age of 18 currently living in your household?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

E7. Does your family have health insurance?

1 = YES

2 = NO

.8 = DON'T KNOW

.9 = REFUSED

E8. To get a picture of people's financial situation we need to know the general range of income of the people we interview. Now, thinking about (your/your family's) total income from all sources, including your job, disability, social security, stock dividends, how much did (you/your family) receive in 2000?

_____ DOLLARS GO TO E9

.8 = DON'T KNOW GO TO E8a

.9 = REFUSED GO TO E8a

E8a. Did (you/your family) receive \$40,000 or more in 1999?

1 = YES	GO TO E8b
2 = NO	GO TO E8d

.8 = DON'T KNOW	GO TO E9
.9 = REFUSED	GO TO E9

E8b. Was it \$50,000 or above?

1 = YES	GO TO E8c
2 = NO	GO TO E8c

.8 = DON'T KNOW	GO TO E9
.9 = REFUSED	GO TO E9

E8c. Was it \$75,000 or above?

1 = YES	GO TO E9
2 = NO	GO TO E9

.8 = DON'T KNOW	GO TO E9
.9 = REFUSED	GO TO E9

E8d. Was it \$5,000 or above?

1 = YES	GO TO E8e
2 = NO	GO TO E9

.8 = DON'T KNOW	GO TO E9
.9 = REFUSED	GO TO E9

E8e. Was it \$15,000 or above?

1 = YES	GO TO E8f
2 = NO	GO TO E9

.8 = DON'T KNOW	GO TO E9
.9 = REFUSED	GO TO E9

E8f. Was it \$25,000 or above?

1 = YES	GO TO E9
2 = NO	GO TO E9

.8 = DON'T KNOW	GO TO E9
.9 = REFUSED	GO TO E9

E9. Which of the following best describes your ethnic background?... Are you (READ LIST)
(CHECK ONE)

- ___ 1 = White,
- ___ 2 = Black or African American (EXCEPT HISPANIC),
- ___ 3 = Hispanic,
- ___ 4 = Asian or Pacific Islander, or
- ___ 5 = American Indian or Alaskan native?

- .8 = DON'T KNOW
- .9 = REFUSED

READ: That completes our survey. Thank you for your help.

DON'T ASK THE LAST QUESTION BUT RECORD ANSWER.

E10 . RESPONDENT WAS

- 1 = MALE
- 2 = FEMALE

Biographies of Authors

Gregory Elliehausen, Ph.D., is Senior Research Scholar at the Credit Research Center. His research specializes in the economics of markets for consumer and small business financial services. Current research activities include investigations of determinants of delinquency, measurement of household debt burden, market structure of consumer credit markets, effects of market innovations on small businesses access to credit. Before joining the Credit Research Center, Dr. Elliehausen was an economist on the staff of the Board of Governors of the Federal Reserve System from 1981-1998. He conducted research and prepared analyses on the effects of financial regulations, especially consumer protection regulations for financial services. He was also involved in the design and implementation of major data collection projects, including the Survey of Consumer Finances and the Survey of Small Business Finances.

Edward C. Lawrence, Ph.D., is a Professor of Finance and the Department Chair at the University of Missouri - St. Louis. Prior to becoming an academic, he worked professionally in public accounting and commercial banking. He has been at the University of Missouri - St. Louis for 19 years and teaches in the areas of corporate finance, commercial banking, security analysis and real estate. Ed's research expertise is in the area of consumer finance and banking. He actively consults with companies and attorneys around the U.S. His clients have included many financial institutions and Fortune 500 companies like Southwestern Bell and Ralston Purina. In addition, he has been a lead researcher on several major multi-year contract research projects for Citicorp and Wells Fargo Bank. He has published more than 30 papers in leading professional and academic journals.